



USAID Development Assistance Programs and Corruption April 2003

Management Systems International

600 Water Street, SW, Washington, DC 20024 USA

Authors: Laurence Beck

Vicky Michener

Helen Grant

Submitted to: United States Agency for International Development
USAID Contract: IQC No. AEP-I-00-00-00024-00, Task Order no. 3
MSI Project No. 4308-001

Table of Contents

Executive Summary	Error! Bookmark not defined.
I. INTRODUCTION.....	1
II. CORRUPTION VULNERABILITY FACTORS IN DEVELOPMENT ASSISTANCE	3
III. TECHNIQUES AND METHODS TO REDUCE CORRUPTION.....	10
IV. CONCLUSION	24

ANNEXES

Annex 1 – Causes of Corruption

**Annex 2 – Corruption and Quick Ramp-ups of Foreign Assistance, Bibliography and
Persons interviewed**

Annex 3 – Country Case Studies

EXECUTIVE SUMMARY

The accountability techniques and methods that USAID has developed and implemented in recent years have been effective in reducing the vulnerability of its programs and projects to corruption. This finding has been reinforced by detailed review of specific cases outlined in OIG and GAO reports and interviews with OIG representatives. This is a particularly significant finding because it shifts the analytical focus from the need to develop new measures to combat corruption to a discussion of how best to utilize and strengthen the methods and techniques that now exist and with which USAID has growing experience. This report provides an analytical framework for developing an accountability strategy for USAID programs and projects based on current approaches that are working.

Meaningful demonstrable progress by USAID toward solid accountability models has obviated the need to dwell on past problems. Instead, the lessons of the recent past suggest that strengthening program and project accountability has become a key USAID management priority. Resulting application of the accountability methods and techniques discussed in this report have the capacity to provide a large measure of protection against the negative impact of corruption on development assistance resources. An added benefit is that USAID is developing an accountability expertise with applicability to new and different development assistance models currently under discussion.

The principal accountability techniques and methods used by USAID fall into six broad categories:

- Choosing the most corruption-resistant funding mechanism that will meet program development objectives via risk assessment
- Making accountability a management priority
- Aggressive auditing and monitoring of program and project resources
- Application of strict financial management guidelines to those responsible for implementing programs and projects
- Coordination of monitoring activities with other donors and other US Government agencies
- Establishing sustained substantive anti-corruption programs and projects in recipient countries.

Of these, the first two – designing programs and projects based on a solid risk assessment and a strong management commitment to accountability – are the foundation upon which a comprehensive accountability strategy can be built. Choosing among the techniques and methods that will form the core of a specific accountability strategy requires reference to specific vulnerabilities and practical limitations. For example, the aggressive auditing and monitoring component could include early OIG involvement, increased Mission audit and monitoring staff

and fraud awareness training. Added to the strategy to meet specific concerns about implementer vulnerability might be a pre-project implementation conference that would include basic financial management training. The strategy might then be filled out by a longer-term effort to develop the capacity of a host country Supreme Audit Institution as part of a substantive anti-corruption program.

To assist in defining risk, this report first addresses certain factors that impact on the vulnerability of development assistance to corruption. Without understanding and assessing the specific vulnerabilities of a planned program or project, it is virtually impossible to determine the accountability methods and techniques that will produce an effective accountability strategy. Once developed, full implementation of effective accountability strategies can help ensure that USAID programs and projects maximize their substantive potential. The good news is that there is a growing consensus that the accountability techniques and methods discussed in this report are working and that careful development and implementation of accountability strategies can be effective deterrents to corruption even in the most difficult of circumstances.

This report expands on material developed in an earlier report, the critical portion of which is contained in the accompanying Annexes 2 and 3. That report explored methods identified largely by USAID program personnel that have been utilized to reduce corruption, primarily in situations involving large infusions of additional development assistance in countries that had previously received either a relatively steady flow or very limited flow of aid. From the earlier report and from discussion with OIG representatives, review of OIG reports, GAO reports and other materials, this report details and describes those methods and techniques presently utilized by USAID to meet the challenge of meaningful accountability for development assistance funds.

Although many of the examples in this report and much of the discussion in Annexes 2 and 3 focus on programs and projects that involve infusion of large amounts of assistance in response to disaster, emergency or agreement, the analytical framework outlined in this report is equally applicable to programs and projects that involve routine delivery of development assistance and everything in between. Further, by emphasizing accountability as a priority and demonstrating the capacity to develop and implement meaningful accountability strategies, USAID strengthens its capacity to ensure that use of development resources is maximized to achieve development ends and positions itself as a constructive example for the populations it serves.

I. INTRODUCTION

Public corruption is a cancer that continues to undermine sustainable economic, political and social development in much of the developing world. Despite the investment of billions of dollars in public and private funds, many developing countries continue to lose ground to elements within their own societies that use government and governance as a means to private and personal gain. In addition, public sector corruption breeds private sector corruption and public contempt for government institutions, further eroding the capacity of reform elements to meet even modest objectives. The end result is a societal imbalance that works to enrich those who take advantage of weak, corrupted institutions at the expense of those lacking the capacity to even enter the arena. (See Annex 1 for a brief discussion of the causes of corruption.)

In these corrupt environments, USAID programs and projects are frequently targeted by unscrupulous elements in the very societies intended to be the beneficiaries of development assistance. In fact, in some instances, development assistance from the US Government (USG) and other donors is the principal resource left to steal. In response, **USAID has developed and utilized a range of techniques and methods aimed at reducing the impact of corruption on its programs and projects. The techniques and methods fall into six broad categories:**

- Choosing the most corruption-resistant funding mechanism that will meet program development objectives – risk assessment
- Making accountability a management priority
- Aggressive auditing and monitoring of program and project resources
- Application of strict financial management guidelines to those responsible for implementing programs and projects
- Coordination of monitoring activities with other donors and other US Government agencies
- Establishing sustained substantive anti-corruption programs and projects in recipient countries.

These techniques and methods are analyzed in this report with reference to developing a USAID **accountability strategy** for each significant program and project that addresses specific corruption vulnerability factors. Many of the techniques and methods, as well as the vulnerabilities they address, have been identified by reviewing selected major development assistance programs, especially those involving large infusions of additional assistance in countries that had previously received either a relatively steady flow or very limited flow of aid. Discussion of these techniques and methods in the context of developing a practical accountability strategy is intended to serve as a useful tool for policy makers considering implementation and accountability issues associated with the Millennium Challenge Account (MCA), as well as traditional USAID programs and projects.

At the outset, it is extremely important to distinguish between development assistance program objectives and accountability objectives. Often there is an understandable confusion between substantive programs that seek to reduce public corruption in a given country and methods utilized to prevent or reduce corruption associated with the *implementation* of the substantive programs themselves. On occasion and in the long term, substantive anti-corruption programs may impact on the capacity of a government to monitor and account for development funds with which it is entrusted. However, sustained substantive anti-corruption programs and activities undertaken abroad by USAID and other USG entities should not be viewed as a substitute for rigorous application of accountability techniques and methods *within assistance programs* that are targeted at recognized vulnerabilities.

This report seeks to provide an analytical framework for evaluating such accountability techniques and methods. In doing so, substantive sustained anti-corruption programs and activities are but one of the methods examined. In the context of the MCA or any other program that may entrust funds to host country institutions, USG assistance to host country institutions aimed at reducing corruption will almost inevitably focus on building the capacity of the host country institutions to reliably utilize the other techniques and methods addressed in this report.

As a starting point for identifying corruption vulnerability factors and the techniques utilized to address the vulnerabilities, a review was undertaken of selected major development assistance programs, especially those involving large infusions of additional assistance in countries that had previously received either a relatively steady flow or very limited flow of aid. This methodology was chosen because these circumstances frequently create the greatest opportunity for corruption and, therefore, the greatest challenge to devise strategies to impede corruption. (Annex 2 contains the results of the initial review, and Annex 3 contains the individual country case study interview notes.)

Following the initial review, the vulnerability factors were augmented by reviewing material from the USAID Office of the Inspector General, the General Accounting Office, and other auditing and evaluation entities that have examined accountability issues related to USAID programs and projects. Then, using many of the same sources, the detailed list of techniques and methods was developed and given descriptive content.

II. CORRUPTION VULNERABILITY FACTORS IN DEVELOPMENT ASSISTANCE

In published remarks made on May 29, 2001, to the Global Forum on Fighting Corruption in The Hague, Netherlands, Neil Levine, USAID Senior Advisor for Governance, succinctly noted three critical challenges to effective donor assistance in fighting public corruption:

- Keeping Foreign Aid Clean
- Donor Coordination
- Sustainability.

In outlining the first of these challenges, he stated that “our ability to mount and sustain long-term institutional response to corruption depends in large part on our ability to remain completely accountable for the assistance we now provide.” While this specific reference is to donor assistance to fight corruption, the same can be said for all development assistance. If the programs themselves fall victim to fraud, waste and abuse, intended development objectives will inevitably be undermined.

In order to effectively design techniques and methods to reduce or eliminate fraud, waste and abuse from development assistance programs, it is critical to understand the factors in the planning and implementation of the programs themselves that create vulnerability to corruption. This report identifies and discusses **six vulnerability factors**:

1. Program design – project/technical assistance or block grants/budget support payments
2. Political considerations
3. Program/project objectives
4. Personnel issues
5. Weak and/or dispersed implementers
6. Problems with end-use monitoring.

In each instance, decisions made by USAID policy planners and management personnel will have an impact on the vulnerability of resulting programs and projects to corruption. Further, some of the most important decisions that affect vulnerability may be made by others outside USAID who may not recognize the vulnerabilities created by the decisions made or may have other priorities. An easy example is that budget constraints may reduce staff levels below those necessary for effective accountability of program or project funding. Under any circumstances, recognizing the potential impact of policy and management decisions on vulnerability to corruption will provide guidance on application of techniques and methods that will reduce the potential negative impact.

1. Program Design – Project/Technical Assistance or Block Grants/Budget Support Payments

Despite the absence of empirical data, most in the development community seem to believe that development assistance programmed as block grants, and balance of payments or budget support is more susceptible to fraud, waste and abuse than development assistance utilized to fund projects and technical assistance. While there is no solid evidence concerning this assertion, the point is made that programming design decisions can have a significant effect on accountability issues.

Donor organizations recognize two general types of aid delivery mechanisms: direct budget support and project aid. Project aid funds a discrete set of activities, frequently implemented by a contractor or a grantee. Donor funds are usually disbursed gradually to the implementer over the course of the project. Budgetary support or balance of payments support, on the other hand, is a more generalized transfer of resources directly to a foreign government. The funds can be aimed at supporting sectoral or broad program policies, but do not necessarily have to be. They can also serve to reduce host country debt or to meet economic and political stabilization objectives. Budget support is generally disbursed more rapidly than project funds and often disappears into the recipient country's general fund.

USAID terminology distinguishes between “project” and “non-project” assistance (in addition to PL480 food aid). Non-project assistance consists of sector program assistance (SPA) and balance of payments and budget support (BPB). SPA generally supports specific sectoral objectives while BPB is general support for political and economic stability. Non-project funds (also known as grants to foreign governments) can take the form of cash transfers to the government or Commodity Import Programs. There is often a counterpart fund of local currency provided by the recipient government as part of that government's agreement with USAID. The resulting local currency accounts are generally owned by the host country but programmed jointly with USAID, a situation creating its own distinct vulnerabilities to corruption.

Project assistance frequently results in implementation through USAID contracts, grants, cooperative agreements or credits to recipient government agencies, NGOs, consulting companies or other private sector institutions. Disbursement of funds is usually gradual and controlled by a number of well-defined financial procedures (see ADS series 500 and 600). While this may on the surface appear to be more resistant to corruption than direct cash transfers, the integrity of the process is heavily reliant on the institutional integrity of the implementers. Further, because funds may pass through many hands and be utilized in a variety of ways, effective monitoring is costly and must be well programmed to meet the specific vulnerabilities associated with each project plan. As an added concern, project assistance often involves procurements of goods and services, a key aspect of increased vulnerability to corruption.

USAID provides significant amounts of non-project assistance. Current or recent examples include budget support or balance of payments support to Egypt, Bosnia-Herzegovina, Montenegro, Jordan, Pakistan, and Israel. Continued experience with non-project assistance, spurred on by the belief that it is inherently more susceptible to misuse, has led in recent years to

more effective accountability models that call into question some of the earlier assumptions about the inherent corruption vulnerability of non-project assistance.¹

Since it is likely that both project and non-project assistance will continue to be utilized by USAID to meet development objectives, early assessment and analysis of the specific accountability issues associated with each program or project is the most important element in developing a strategy to reduce vulnerability to corruption. This thinking is reflected in discussions of the numerous types of programs that might be supported by the MCA, a discussion that contemplates both project and non-project assistance as viable options.²

2. Political Considerations

Since their inception, the foreign economic assistance program of the United States and similar programs of other donor countries and entities have had an understandable political component. Some portion of political influence on the overall programs is reserved for rewarding our friends and punishing our enemies, but a large measure is the byproduct of a perceived need to respond to humanitarian crises and international emergencies, and to meet obligations under bilateral or multilateral agreements. Fundamental to all of these circumstances is the very real potential for subordination of accountability to other imperatives.

In providing humanitarian and emergency relief (disaster relief), there is generally the imperative to provide a rapid response with significant resources in an environment where infrastructure and institutions either have been destroyed or were of limited strength to begin with. This is a prescription for accountability disaster unless great care is taken to address specific vulnerabilities upfront.

The most critical vulnerability to corrupt misuse or loss of resources in these situations is fairly obvious – the need to respond quickly with significant resources is generally driven by a palpable crisis. Since nothing will change this as a characteristic of the assistance, careful application at the outset of the techniques and methods to reduce corruption that have been utilized by USAID in similar circumstances can maximize the potential for meaningful accountability in the most difficult of circumstances. Of additional concern in these circumstances is that procurement of goods and services needed to meet the crisis frequently cannot meet standards designed to reduce the likelihood of procurement fraud. Study of the implementation of disaster recovery and reconstruction assistance in Latin America and the Caribbean following Hurricanes Mitch and Georges in 1998 is very instructive in analyzing successful application of an accountability strategy under very difficult circumstances. (See discussion in Section III below.)

¹ This discussion does not address the overall policy issues associated with the fungibility of money. At some point in most project assistance, funds are transferred to a host country government or institution, and that transfer frees up a portion of the recipient's budget for use on other activities, some or all of which may be of dubious value in the development process.

² See Congressional Research Service Report to Congress, The Millennium Challenge Account: Congressional Consideration of a New Foreign Aid Initiative, January 3, 2003.

Development assistance resulting from bilateral or multilateral obligations undertaken for political reasons presents accountability challenges that are well known. **To a large extent, unless accountability is a fundamental element of the underlying agreements and penalties for non-compliance are established and enforced, accountability will always be a secondary consideration to the political objectives driving the agreements in the first place.** This type of vulnerability to corruption will inevitably require creative application of accountability strategies to the full extent permitted by the underlying agreements. If the MCA develops, as proposed, free of politically motivated cash transfers, at the least the MCA funding source should be able to avoid vulnerabilities associated with politically required cash transfers.

3. Program/Project Objectives

The vulnerability factors associated with program and project objectives are perhaps the most easily avoided. **Elevation of accountability concerns to a high priority during the process of developing program and project objectives can go a long way toward avoiding accountability and monitoring problems.**

As with the political considerations discussed above, there is a tendency to set program and project objectives without adequate consideration of accountability issues. Program personnel frequently lack an in-depth understanding of accountability techniques and methods and may view accountability concerns as little more than an impediment to meeting program and project demands. The assessments and analyses utilized in program and project planning frequently overlook or minimize accountability issues. In this context, overly optimistic assessments of host country institutional capabilities and implementer integrity can lead to disastrous results that undermine otherwise worthy projects.

Programs and projects are most vulnerable to corruption when substantive objectives are set without reference to or in spite of accountability concerns. There are times when a reduction in accountability standards and procedures may be necessary to meet actual project demands. For example, a project to provide assistance in rural villages lacking in fundamental infrastructure may require different accounting procedures than a similar project in a more developed part of the same country.

Another element of corruption vulnerability associated with determination of program and project objectives is unrealistic management expectations or priorities. This can take many forms, but for purposes of this discussion, management expectations or priorities inconsistent with sound accountability principles may imply to implementers that accountability standards and/or procedures can be altered to meet those expectations or priorities. A USAID project manager who repeatedly asserts that completion of the water project on time is expected of the implementer runs the risk of sending the wrong message with respect to accountability.

In developing sound program and project objectives, a determination to include procurement and/or commodity assistance should always take into consideration the vulnerabilities associated

with this type of assistance.³ Procurements of any type funded with development assistance money are persistent targets of fraud and abuse, particularly those carried out by host country institutions accustomed to operating without the strictures of a meaningful procurement system.

In addition to the potential for fraud associated with the purchase itself, any procurement can be subject to post-purchase distribution problems even if the procurement process produces the desired goods at a fair price from a competitive vendor. The same distribution problem is posed by virtually all commodities programs. In essence, there exists in many instances a significant risk that the goods will not end up where they are supposed to end up or will not be used for their intended use.⁴

4. Personnel Issues

In assessing the vulnerability of development assistance to corruption, an often overlooked factor is staffing levels. While the need for additional staff to implement programs and projects is frequently stated, very rarely do those responsible for program or project implementation request more auditors. Understaffed planning and implementation creates obvious vulnerabilities to problems of all sorts, not just corruption. Yet, inevitably, poorly planned and executed programs and projects have as an added cost an increased vulnerability to corruption.

It is not just numbers that matter. **If accountability is to be a program or project priority, personnel with the skill sets that provide meaningful accountability must be assigned in sufficient numbers to guarantee appropriate coverage, and they must be empowered to provide that coverage.** The absence of appropriate monitoring staff or the obvious diminished authority of existing monitoring staff sends a strong signal to those interested in converting program or project assets to their own use.

Another personnel issue that can have a significant impact on vulnerability to corruption is the content of personnel training. Program and project personnel with planning and implementation responsibilities frequently lack even fundamental fraud awareness skills. How many project managers would know the indicia of a fraudulent invoice? Further, while US Government ethics training is a part of all USAID personnel training, sensitivity to country specific or cultural ethical norms is not. When USAID personnel remain unaware of local norms and practices, or choose to discount their impact, obvious signs of corruption can be missed.

Further, since a significant portion of program and project implementation is carried out by cooperating country and third country nationals, analysis of personnel issues related to accountability should be extended to all individuals with implementation responsibilities. In analyzing the potential vulnerability consequences of personnel decisions, it bears noting that lower level personnel, regardless of nationality, can be the source of major accountability breaches, sometimes simply because they are often the least trained in understanding and preventing fraud, waste and abuse.

³For example, in August 2000, a German company plead guilty in a US District Court to rigging bids on USAID construction contracts in Egypt.

⁴ See discussion of end-use monitoring in subsection 6, *infra*, for examples.

5. Weak and/or Dispersed Implementers

Implementation of programs and projects in developing countries generally requires a significant level of cooperation with host country governmental institutions, as well as individuals and organizations in the private sector. **Some institutions and organizations develop a track record of quality performance while others are either new to the process or have been previously problematic.** Further, some situations dictate continued work with problematic partners for either political or substantive reasons. For example, a project aimed at improving public health clinics will almost inevitably have to work with the host country Ministry of Health in some fashion, even if previous experience with that institution has been less than satisfactory. Likewise, there may be a very limited number of local suppliers of needed goods and services none of which meets acceptable accountability or quality control standards, thus requiring USAID personnel to choose among poor choices or abandon the procurement.

Even relatively capable institutions and organizations can raise significant accountability issues when institutional or organizational management and/or personnel are widely dispersed. Accordingly, accounting for commodities distributed by the same organization from a dozen locations in a country will almost assuredly be more difficult than accounting for distribution of the same amount of commodities from a single distribution point.

Another variation on the accountability problems created by dispersed implementers occurs when a single resource is divided among many small implementers for project related reasons. From an accountability perspective, it will generally be easier to work with a single NGO to implement a particular element of a project than to provide the same total level of funding or resources to several NGOs. However, project management may desire to try to build organizational capacity in a group of implementers (e.g. NGOs) by giving each of several units the opportunity to participate in a given activity.

Finally, accountability problems can occur when assumptions are made about the capability of a type or group of organizations or institutions based upon experience with one or a few units. For example, expansion of a successful pilot project with one local government in a country to several local governments can be problematic if assumptions about accountability are simply imputed to each new unit to receive assistance.

6. Difficulty of End-Use Monitoring

Because development assistance by its nature is often provided to countries and in environments with weak institutions and weak infrastructure, meaningful end-use monitoring can be very difficult. Accounting for disbursements of funds by USAID is the easy part. **Generally, USAID will know to whom they gave funds and will have some evidence that the funds have been spent in accordance with the agreements underlying a particular program or project. However, that does not necessarily mean that the agreed-upon end use associated with disbursed funds has actually been accomplished.** In its simplest form, if USAID decides to buy ten Xerox machines for the Ministry of Health to be utilized in hospitals to ensure that patients leave the hospital with written instructions for home care, there is almost sure to be

evidence that the Xerox machines were purchased with the assistance funds. The accountability difficulties in this example arise in answering questions both about the procurement itself and whether or not the machines are in the designated hospitals and being used for the intended purpose.

The example above is a very basic example to illustrate a point. Simply having a paper trail to follow neither guarantee that the paper is genuine or accurate, nor does it guarantee that an intended end use has been realized. While this is particularly true with procurements and distribution of commodities, problems in monitoring end use can arise across the board. Using project funds to purchase technical assistance in institution- or capacity-building usually is accompanied by some type of report or invoice indicating that the assistance has been delivered but hardly guarantees that value has been received commensurate with the agreed-upon purchase price.

It bears noting in discussing end-use monitoring in the context of this report that addressing accountability issues does not address the issue of whether or not particular development assistance funds achieve projected development objectives. Rather, the end use monitoring discussed above is limited to USAID's ability to determine that funds have been expended properly and have been used for the intended purpose.

III. TECHNIQUES AND METHODS TO REDUCE CORRUPTION

Recognizing program and project vulnerability to corruption is the constructive first step toward developing effective management and oversight tools – techniques and methods – to reduce the impact of that corruption. As noted above, this report addresses accountability objectives and issues as distinguished from anti-corruption substantive program objectives and issues. Therefore, substantive sustained anti-corruption programs are examined below only for their impact on USAID’s responsibility to account for program and project resources.⁵

The techniques and methods discussed below have been derived, in part, from interviews with USAID program personnel and review of available literature. Much of this portion of the work focused on USAID programs in countries where there had been a rapid increase of foreign assistance over previously established levels. (See Annex 2 for a discussion of the results of the interviews and review of the literature and Annex 3 for country-specific case studies.) In refining the list of techniques and methods, USAID Office of the Inspector General (OIG) senior audit personnel were interviewed, and a wide range of OIG audit reports, GAO reports and other materials relating to accountability issues were reviewed.

Perhaps the most significant finding to report is a growing consensus that the techniques and methods that have been developed in recent years are actually working to address major accountability concerns. OIG representatives noted their perception of a growing “culture change” at USAID that features management embracing accountability as a priority and a desire to include the OIG in the accountability model. Some of this is a byproduct of the overall success of accountability efforts in conjunction with the implementation of disaster recovery assistance in Latin America and the Caribbean following Hurricanes Mitch and Georges in 1998, and other successes, and some is the result of an apparent evolution toward an understanding that accountability is fundamental to successful programs and projects rather than an imposed irritant.

This is good news for USAID’s programs and projects, whether in rapid response situations or not, and may help to clarify an important role for USAID as the details of the MCA begin to emerge. In testimony before the Senate Foreign Relations Committee regarding the MCA on March 4, 2003, Alan Larson, Undersecretary of State for Economic, Business and Agriculture Affairs, stated that to implement the intended partnership between the MCA and MCA countries “the MCA will use time-limited, business-like contracts that represent a commitment between the United States and the developing countries to meet agreed performance benchmarks.” The Undersecretary went on to say:

“Developing countries will set their own priorities and identify their own greatest hurdles to development. They will do so by engaging their citizens, businesses and government in an open debate, which will result in a proposal for MCA

⁵ The techniques and methods discussed in this section bear review by those developing substantive anti-corruption programs, particularly in addressing host country accountability issues. Many of the techniques and methods discussed herein are equally applicable to host country institutions and organizations seeking to account for their own resources, whether donated or generated from within.

funding. This proposal will include objectives, a plan and timetable for achieving them, benchmarks for assessing progress and how results will be sustained at the end of the contract, delineation of the responsibilities of the MCA and the MCA country, the role of civil society, business and other donors, and a *plan for ensuring financial accountability for funds used.*”

Two days later, on March 6, 2003 in Congressional testimony before the House International Relations Committee, Andrew S. Natsios, Administrator of USAID, noted his expectation “that MCA funds would be disbursed directly to institutions implementing activities under the MCA contract through the, most *flexible, but accountable mechanisms.*”

These statements suggest the recognition that accountability is a priority MCA objective, but neither statement offers detail as to how this objective is to be realized. The techniques and methods discussed below could be as useful in meeting MCA accountability objectives as they have proven to be in reducing corruption across the broad spectrum of development assistance programs and projects funded by USAID. While none is a panacea by itself, USAID experience suggests that careful analysis and application of a particular methodology or a group of techniques and methods can significantly reduce corruption.

The techniques and methods fall into six broad categories:

1. Choosing the most corruption-resistant funding mechanism that will meet program development objectives – risk assessment
2. Making accountability a management priority
3. Aggressive auditing and monitoring of program and project resources
4. Application of strict financial management guidelines to those responsible for implementing programs and projects
5. Coordination of monitoring activities with other donors and other US Government agencies
6. Establishing sustained substantive anti-corruption programs and activities in recipient countries.

As a very useful reference point for discussion of the application of the above methods and techniques to actual programs and projects, **OIG representatives**, in discussing situations in which a rapid increase of assistance above previous levels is contemplated, **offered five critical factors in addressing corruption concerns:**

- Top management support for accountability stated early and clearly
- Careful analysis of the risks – a risk assessment combined with a measure of professional skepticism

- Staff and partners educated and knowledgeable about what can go wrong and about practical responses to what does go wrong
- Continuous presence of oversight from both the IG and well-trained program officers (CTOs)
- Clear and continuous reporting as part of a process designed to ensure that final actions are taken based on reporting results.

Further, OIG representatives discussed the accountability effort with respect to the Central American and Caribbean disaster recovery program as **a model to be followed** in similar circumstances. It served as a laboratory of sorts for defining successful accountability strategies applicable to virtually all development assistance programs and projects that are highly vulnerable to corruption.

An Accountability Success: Central America and the Caribbean Emergency Disaster Recovery Fund

The Central America and the Caribbean Emergency Disaster Recovery Fund (CACEDRF) totaled \$621 million. The fund was established in May 1999 in the aftermath of the devastation caused by Hurricanes Mitch and Georges to implement the US Government's recovery and reconstruction activities in multiple countries in the region. By all estimates, the program was a substantive success. In addition, despite working in multiple countries with weak or weakened infrastructures and the need to respond quickly to emergency conditions, the program was an accountability success.

The USAID Office of the Inspector General Semi-Annual Report to Congress, April 1, 2002 - September 30, 2002 explains:

"As part of its oversight effort, the OIG conducted a series of risk-based audits that included quarterly concurrent financial statement audits of activities deemed to be of high risk and annual financial statement audits of moderate and lower-risk activities. Activities were also subject to performance audits conducted by OIG auditors. In addition, the OIG provided fraud awareness training to 2,141 participants in the CACEDRF countries. This training was directed to employees of USAID and its partners who were managing USAID funds on a day-to-day basis and who had first-hand knowledge of how USAID funds were being used. The training helped ensure that the participants knew how to prevent and detect common fraud schemes and were aware of their responsibility to report suspected fraud to the OIG.

For the concurrent audits of high risk activities, audit work was performed throughout the year, and quarterly audit reports were produced, providing a deterrent effect and substantially reducing the possibility that accountability problems could occur without being detected. Further, the OIG kept bureau staff and the Congress informed about these results through regular meetings and briefings. A major conclusion of the report is that a risk-based approach, which includes activities directed toward preventing problems from occurring as well as detecting them through audits and investigations, can be effective in making sure that USAID funds are spent effectively and for agreed-upon purposes.

The OIG's financial statement audit reports on the CACEDRF program disclosed \$7.6 million in questioned costs, 229 reportable internal control conditions, and 223 instances of material noncompliance with agreement terms and applicable laws and regulations. Over time, as auditors found problems and worked with grantees and contractors to correct them through the audit recommendation follow-up process, grantees and contractors improved their administrative procedures and systems of internal control. As a result, over the course of the program, questioned costs as a percentage of total audited costs, at the time the work was conducted, fell significantly, from 7 percent to 2 percent."

The discussion of the methods and techniques that follows will give guidance in developing a program or project accountability strategy. Each situation will be different, but certain constants will emerge. Many of the constants in an overall accountability strategy will find a ready match with the factors enumerated by OIG representatives.

1. Choosing the Most Corruption-Resistant Funding Mechanism that Will Meet Program or Project Development Assistance Objectives – Risk Assessment

The vulnerability discussion in Section II above essentially concludes that **vulnerability to corruption has more to do with internal controls than with the type of funding mechanism utilized in a particular program or project.** However, project or program design at the outset may dictate the most effective application of accountability methods and techniques. In making these decisions, **a solid risk assessment is the most useful tool in designing an appropriate funding mechanism to meet development assistance objectives while at the same time developing an accountability strategy that will work.** It bears repeating in this context that despite the best of intentions, a failure to build accountability methodology into project or program design can doom to failure an otherwise good program or project.

Risk assessments should be tailored to the specific program or project, but can take advantage of broad country risk assessments or relatively contemporaneous risk assessments of related programs or projects. In all instances, a good risk assessment requires a realistic evaluation of potential implementers or partners whether the funding will be in the form of project assistance or non-project assistance. If government entities are weak and notably corrupt, it should be fairly obvious that direct cash transfers to those entities should be avoided if at all possible. If political or humanitarian concerns or agreement obligations require cash transfers under these circumstances, program planning should at the least set meaningful criteria that can be measured and aggressive monitoring should be planned and financed as part of the program package.⁶

Careful screening of possible recipient institutions and choosing the better of two or three alternatives can, at the least, reduce corruption risk while permitting other obligations to be met. In designing programs and projects, care should be taken at the outset to avoid high-risk programs and partners in high-risk environments. For example, if the Ministry of Education in a given country is either corrupt or dysfunctional, do not design programs or projects that require that ministry's participation. **Solid risk assessment must be honest risk assessment uncolored by a desire to achieve admirable goals.** Corrupt partners will almost inevitably produce bad results. Developing and distributing a list of unacceptable partners, be they government entities or non-governmental institutions, can make program decisions easier at the outset and avoid

⁶ When the USAID Bureau for Europe and the Newly Independent States (ENI) program was developed, corruption in the Bosnia & Herzegovina government was determined to be high. As a result, the US administration's commitment of \$500 million in balance of payments was noted in the government (GOBiH) ledgers and then immediately transferred to USAID for implementation. See Annex 3.

rediscovering at some program midpoint what others had discovered long before the program began.⁷

Following the conventional wisdom, utilization of project assistance with gradual disbursement of funds controlled by well-defined financial procedures has the advantage of providing close USAID management of resources as the project unfolds and provides numerous opportunities to test accountability before full disbursement. In very high-risk situations, the gradual disbursement feature combined with aggressive auditing and monitoring techniques discussed below may be the only way to prevent loss to fraud, waste and abuse. On the other hand, in low risk situations, gradual disbursement and constant monitoring may retard project progress without providing any greater level of accountability.⁸

Beyond assistance in choosing the most responsible partners and making determinations about the balance between project and non-project assistance, solid risk assessment can assist in avoiding other accountability pitfalls altogether or in part. For example, in some environments, including procurements of goods and services in a project requires such a high level of monitoring that resources could be expended better achieving similar development objectives through other means. Where there are possible choices, making informed choices in the program or project planning stages can go a long way toward determining the remaining elements of a successful accountability strategy. Privatization programs are yet another example. Choosing to support privatization programs may have substantive program value, but can create accountability issues with respect to both criteria for qualifying participants and application of the funds generated by the process.⁹

Some questions have been raised about the impact, in and of itself, of large infusions of aid on corruption and governance. If accountability strategies are specifically designed to address the increased vulnerabilities associated with increased levels of assistance, program planers should not fear a negative impact from large-scale assistance, except to the extent that large-scale assistance can breed unhealthy reliance on assistance itself. Stated another way, as the response to Hurricane Mitch amply demonstrates, the quality of the accountability strategy is more critical to meeting corruption concerns than the quantity of assistance to be disbursed.

2. Making Accountability a Management Priority

A critical role of management is the setting of program or project priorities and determining the distribution of resources in accordance with the established priorities. Historically, from top to

⁷ USAID funding in Bosnia-Herzegovina increased rapidly after the end of the 4 year Bosnian war and the 1995 Dayton Peace Accords. The Bosnian Payments Bureau, an official arm of government, was in effect the Nationalist Party financial clearinghouse. Its operation was the source of many illicit transactions and its dominance was damping the emergence of a banking sector. USAID worked hard to get that Bureau eliminated and eventually succeeded. This was the beginning of the emergence of an honest banking system in Bi-H. See Annex 3.

⁸ Proposed MCA criteria and contract mechanisms may provide some opportunities for delivery of assistance in lower risk environments.

⁹ Problems in the privatization program in Bosnia-Herzegovina are instructive. See the July 2000 GAO Report: "Bosnia Peace Operation – Crime and Corruption Threaten Successful Implementation of the Dayton Peace Agreement," pp 29-32, detailing problems associated with the privatization program.

bottom, USAID management has expended considerable time and money in attempting to determine how best to deliver development assistance to meet changing objectives. Inevitably, this process has resulted in determinations of program and project priorities. Until relatively recently, accountability was not a clearly articulated upper management priority. Accountability concerns were frequently left to financial management personnel and auditors to resolve, often after problems were exposed.

Perhaps spurred on by Congressional concerns and perhaps motivated by an increased understanding that corruption can undermine even the best-intentioned efforts, the disaster recovery assistance program in Central America and the Caribbean seems to have marked a turning point of sorts in the movement of accountability issues to the list of top management priorities in the program development stage. It is perhaps no accident that USAID management, OIG representatives, and the GAO point to this program as a major success in the development and implementation of an accountability strategy that worked.¹⁰

Fundamental to the successful accountability strategy was an early and clear commitment by upper level USAID management to addressing corruption concerns. A review of recent high-volume programs, including those implemented in South Africa, Bosnia, Honduras, and Indonesia, indicates a growing understanding within the ranks of upper management that early and strong emphasis on solid accountability procedures leads to better, less vulnerable, programs.¹¹ Without this commitment, seemingly more pressing needs or substantive concerns can overwhelm early program development, leaving accountability to catch up at a later time.

However, making accountability a management priority requires more than just a statement or two to that effect. As a starting point, it requires that management actions avoid sending a mixed message. Setting substantive program or project deadlines that are incompatible with the solid risk assessment necessary to develop an accountability strategy is but one example of a mixed message from management.

Certain concrete steps represent the type of management commitment to accountability that reinforces the stated accountability objective. Taking steps to ensure full implementation of existing internal control regulations and requirements is a good place to start. This is particularly

¹⁰ USAID/OIG. 2002. "Summary Report on Audits of USAID Assistance Provided Under the Central America and the Caribbean Emergency Disaster Recovery Fund (CACEDRF) Supplemental Appropriation." Report No. 1-598-02-003-S

GAO. 2002. "Disaster Recovery Program Addressed Intended Purposes, but USAID Needs Greater Flexibility to Improve Its Response Capability." Report No. GAO-02-787

Everett L. Mosley, Inspector General and Timothy E. Cox, Regional Inspector General, San Salvador "Statement Before the House Committee on Foreign Operations" March 21, 2001

¹¹ See Annex 3.

true of project assistance where detailed regulations set accountability standards that can be perceived by project personnel as counterproductive to meeting substantive project objectives.¹² Implementation of the regulatory framework for the internal controls applicable to non-project assistance, while somewhat less rigorous, nonetheless requires a strong management commitment in order to reinforce the accountability message.¹³

There are additional useful methods that management can employ to both reinforce the commitment to accountability and to add elements to an accountability strategy that can be tailored to specific circumstances. In particularly vulnerable projects, **using USAID personnel to directly manage projects** eliminates some potential sources of corruption and demonstrates a willingness to commit management resources to ensure a higher level of accountability.¹⁴ Another related method is the **promotion to upper management of individuals with a strong financial management background** and the placement of these individuals in countries or programs at high risk.¹⁵ Direct project management by USAID personnel with meaningful financial management experience, essentially combining the two methods, should be considered when a high priority project carries a high risk of corruption. Additional personnel issues related specifically to auditing and monitoring are discussed below in Subsection 3.

Another management tool that can both demonstrate a clear commitment to accountability and provide added weight to an accountability strategy is the **separation of accountability and monitoring functions from substantive program or project management functions**.¹⁶ The principal advantage of this approach is a monitoring function free of programmatic pressures and prejudices. This can be a particularly useful methodology when there is a very strong management commitment to meeting programmatic objectives in a high-risk environment. For example, the commitment to preventing currency collapse in a country might lead to pressure for direct cash transfers that could conflict with sound accountability principles. By separating the accountability function from the program management function, legitimate accountability

¹² USAID project assistance funds are subject to the Federal Managers' Financial Integrity Act of 1982 (FMFIA). USAID issued Automated Directives System (ADS) Chapter 596 consistent with this law, entitled "Management Accountability and Control," which documents the Agency's policy and procedures for establishing, assessing, correcting, and reporting on management controls. Missions are required to periodically assess the risk environment, and to develop internal control strategies based on the levels of risk in each program area. Oversight is then administered by an internal Management Control Review Committee and is subject to audit by the IG, GAO, and other mechanisms of government accountability.

¹³ Regulations related to accountability for budget support, cash transfers and commodity import programs are more scattered than those related to project assistance. For example, ADS 624, *Host Country-Owned Foreign Currency* regulates accountability for local currency related to non-project assistance. In addition, a February 1996 Policy Paper on program assistance offers additional useful guidance. Regulation of commodity import programs is in ADS 307.

¹⁴ While some consider this approach a financially unfeasible option for most missions, direct supervision of projects was undertaken in South Africa in the beginning of the post-apartheid era. Projects were run directly by USAID staff rather than subcontractors and/or non-governmental organizations, and were thus subject to USAID internal control procedures.

¹⁵ The South Africa Mission hired a former controller as the Deputy Director. The result was added emphasis on accountability procedures in day-to-day mission operations.

¹⁶ The South Africa Mission seeks to ensure that organizations implementing USAID programs and projects separate financial and operations functions. See Annex 3

concerns can get a fair hearing, and some personnel will be dedicated specifically to meeting accountability objectives.

One other management technique bears noting in the context of this section – **outsourcing some project management functions to specialists**. This technique is most often used to assist with major or multiple procurements because there are some procurement management companies that have developed solid reputations operating in environments vulnerable to corruption. A decision to proceed in this manner is generally an admission that neither USAID oversight nor implementer integrity is capable of predictably overcoming the corruption threat. The outsourcing decision can send a strong message that accountability is a priority for the activity in question and can be worth the added cost.¹⁷

3. Aggressive Auditing and Monitoring of Program and Project Resources

With the ensuing discussion of aggressive auditing and monitoring, the interplay between the various techniques and methods to reduce corruption begins to evolve into an accountability strategy. Subsection 1 discussed the utilization of risk assessments and the potential impact that decisions made at the program and project planning stage can have on reducing corruption, and Subsection 2 discussed the role that a strong management commitment to accountability plays in the development and implementation of an accountability strategy. This subsection will add to the mix the auditing and monitoring tools that provide much of the muscle to an accountability strategy. For the auditing and monitoring techniques to be effective, decisions about their application should be preceded by some form of risk assessment and strong management prioritization of accountability. Failure to set this foundation may cause considerable waste of auditing and monitoring resources.

Of most importance, if accountability is to be a management priority in reality, **appropriate resources must be dedicated to providing the auditing and monitoring services required for implementation of a meaningful accountability strategy.** This will require audit and monitoring staff levels appropriate to meet the specific accountability challenges. Generally, this will entail an increase in staffing levels consistent with the level of risk determined by the risk assessment. In some instances, the Latin American disaster recovery assistance program being one prominent example, there is a separate appropriation of funds to cover auditing and monitoring activities. Under any circumstances involving a major accountability effort, **specific funds should be dedicated to cover increased levels of auditing and monitoring.**¹⁸

Determining the appropriate level and timing of auditing and monitoring activities required to meet accountability objectives can be a difficult task, particularly in situations not perceived to entail high risk. Except in high-risk circumstances, some trial and error may be inevitable, particularly where limited resources are available for accountability purposes. On the other

¹⁷ Parsons Delaware, Inc. was selected in 1996 to implement the Municipal Infrastructure and Services Program in Bosnia-Herzegovina. As a major portion of that contract, Parsons managed \$73.4 million in procurement processes.

¹⁸ For example, in the CACEDRF, there was \$1.5 million specifically programmed for additional OIG expenses to ensure appropriate oversight of program funds.

hand, **in programs and projects that must proceed despite high vulnerability to corruption, some form of continuous audit and monitoring oversight should be part of the accountability strategy.** This may involve a combination of tight monitoring by well-trained program officers, increased professional audit presence, and utilization of concurrent audits (discussed below) or a similar intense audit program. **In order to take advantage of intensive monitoring and audit activities, it is essential to implement a clear and contemporaneous reporting process that includes ongoing follow-up to ensure that reported problems are resolved in a timely fashion.**

Any aggressive monitoring program should include **the explicit requirement that all required internal procedures be followed by those responsible for implementing programs and projects.** This is the relatively obvious follow-on to the point made in the previous subsection that an important element of management commitment to accountability is taking concrete steps to ensure full implementation of existing internal control regulations and requirements. As noted earlier, strict adherence to internal controls may not always seem compatible with meeting program or project objectives, but doing so is essential to meeting accountability standards.¹⁹

In developing and managing an accountability strategy, there is an apparent increased management willingness to **involve OIG personnel in the process.** Particularly where there is a perception of high vulnerability to corruption, **early OIG involvement in risk assessment and developing an accountability strategy** can be critical to the ultimate success of the accountability effort.²⁰ Early involvement of OIG personnel in the risk assessment process has an important additional benefit. Once the level of risk is measured, OIG personnel can assist in developing an accountability strategy to address the specific risks and can provide both guidance and assistance in implementing the strategy.²¹ One technique that has proven extremely valuable in high-risk situations, whether implemented by the OIG or contract auditors, is **the concurrent audit.** This is essentially a continuous audit process that produces reports on a quarterly basis, as opposed to the more common annual audit. Although concurrent auditing is a resource intensive technique, it has proven very effective in providing audit results in a timeframe in which needed corrections can be made before problems become too well entrenched. In addition, the routine presence of auditors serves as a meaningful deterrent to many forms of corruption.²²

The OIG is being utilized to provide another valuable tool in addressing program and project vulnerability to corruption - **training in fraud awareness and monitoring techniques for**

¹⁹ See Testimony of Jess T. Ford, Director, International Affairs and Trade, GAO, “Implementing Disaster Recovery Assistance in Latin America,” in which this issue is addressed in the context of the Hurricane Mitch recovery and reconstruction program.

²⁰ This report does not address any potential conflict of interest issues associated with active OIG participation in developing and implementing an accountability strategy. It is enough to note that USAID program representatives and OIG representatives seem to believe that the evolving relationship between USAID management and the OIG is having a positive impact on meeting accountability challenges.

²¹ In Nigeria and the Democratic Republic of the Congo, the OIG did risk assessments of the USAID-financed assistance to those countries. These assessments are overviews of existing programs that can be very useful in developing accountability strategies.

²² See the discussion of concurrent audits with respect to CACEDRF in the OIG Semiannual Report to Congress, April 1, 2002-September 30, 2002, p.6. Concurrent audits have also been successfully used in Mozambique.

USAID personnel and for the staff of implementing partners. Trained project staff, whether USAID personnel or not, are the first line of defense against fraud and other types of corruption. Aggressive monitoring of program and project activities requires knowledgeable personnel with a clear management mandate to report concerns to appropriate authorities.

Aggressive monitoring in the computer age suggests the development of information technology applications that assist the process. Without entering the debate over the adequacy of USAID financial management systems²³ any meaningful accountability strategy is only as good as the information obtained. As USAID continues to develop its financial management systems to meet Federal legal requirements, valuable tools can be developed that will track and report the information necessary to ensure full accountability. In designing an accountability strategy for a particular program or project, available IT applications should become a routine integral part. If no viable application is available, relatively simple databases can be developed to meet specific needs. For example, in a country where USAID projects involve significant in-country procurements, development of product, price, and vendor databases can significantly impact on the integrity of the local procurement process.²⁴

Two techniques involving outreach to host country institutions can be important components of an aggressive monitoring program. First is the **involvement of host country Supreme Audit Institutions**, or the equivalent, in the auditing and monitoring process for USAID programs and projects, assuming that these institutions have the capacity to be of assistance. The OIG has a process for approval of these institutions, essentially certifying that they meet required standards to be a participant in the USAID auditing and monitoring program.²⁵ As partners, these institutions can provide valuable insight into local conditions and valuable manpower to the information gathering process. Another method, not often used, is **ethics outreach to recipient communities**. Particularly in projects where host country organizations or even individuals have a well-defined stake, informing stakeholders about ethics, basic fraud awareness, and the potential for misuse of resources and providing a reporting avenue can produce significant results.²⁶

²³ Both the GAO and the OIG have been critical of USAID financial management and information technology systems, although both sources have recognized recent progress. See, e.g., GAO Report “Major Management Challenges and Program Risks – USAID,” January 2003.

²⁴ In Kyrgyzstan, USAID funded a pilot project aimed at developing procurement databases designed to improve both the efficiency and integrity of the procurement process.

²⁵ Training programs to build the institutional capacity of Supreme Audit Institutions and the approval process is discussed in Subsection 6.

²⁶ During the USAID transition initiative in Georgia, public service announcements were distributed through the media as a part of the anti-corruption strategy. The US Justice Department, along with USAID, sponsored this activity. In Bosnia, informants suggested that an effective anti-corruption campaign requires a massive public information dissemination and should explicitly target youth and encourage whistle blowing. See Annex 2

4. Application of Strict Financial Management Guidelines to Those Responsible for Implementing Programs and Projects

To this point, the successful application of the techniques and methods to reduce corruption has been largely a function of USAID management commitment to accountability and selection and implementation by USAID of the most appropriate tools to address perceived risk. This subsection addresses the next step in developing an overall accountability strategy - **involvement of host country implementers**. To be successful, USAID must develop partnerships committed to meeting financial management goals for which the host country implementers may be poorly prepared.²⁷

Building the capacity of implementing partners to effectively participate in the overall accountability strategy requires a combination of training and provision of basic accountability resources. The focus of this effort should be on the development of the financial management capacity of the implementing institutions themselves. These are the institutions, be they governmental or non-governmental, to which USAID disburses funds for meeting program or project objectives. Further, this should be a program or project specific activity, in lieu of the long-term sustained anti-corruption programs and activities discussed in Subsection 6 below.

As with so much of the overall accountability strategy, selection of specific techniques or methods will depend on assessment of risk. For purposes of targeting financial management training and resource distribution, there should be some analysis of existing financial management capacity. In some cases, the risk of a corrupt outcome may be so high that a proposed implementing institution should be eliminated from consideration, an issue discussed previously in this report. On the other hand, an NGO or a host country government agency may have more than enough staff with financial management experience, but may be lacking the computers and copying machines necessary to manage the anticipated infusion of USAID funds. In this context, **it bears noting that a frequently overlooked aspect of risk assessment is recognition of what is being done right.**

Thus, **a key aspect of an overall accountability strategy is to train and equip NGOs and governmental institutions in the fundamentals of financial management and monitoring.** The training and equipment will be most useful in achieving program and project accountability objectives if it is program or project specific. Train and equip the institutions to meet their responsibilities to the program or project at hand.

Another related technique utilized successfully is the **pre-project implementation conference**.²⁸ These conferences and other pre-disbursement activities that emphasize accountability

²⁷ As part of its “expand accountability” efforts, USAID regularly trains its local partners in financial management and auditing procedures. According to the OIG Semiannual Report to Congress, trainings between April and September of 2002 included Mission partners in Nepal, South Africa, Russia, Moldova, and Ukraine.

²⁸ At the start of each new major project in Egypt, USAID holds a pre-project implementation conference. The conferences, organized by the mission Controller’s office, are attended by key project implementers who are trained in areas of project vulnerability to corruption and methods to ensure project integrity.

requirements can help responsible implementing institutions try to ensure that they have the capacity to meet accountability expectations. These pre-disbursement activities can also avoid last minute disbursement delays caused by misunderstandings about host country institution accounting responsibilities and the capacity to meet them.

One other useful tool worth noting in promoting active accountability partnerships with host country institutions, particularly government institutions, is to **identify and seek to reinforce host country commitments to international anti-corruption measures**. The Inter-American Convention Against Corruption is but one such set of international obligations to which many aid recipient countries in Latin America have subscribed.²⁹ For example, reminding a host country government agency responsible for implementing a USAID project that they are part of a government that has committed itself to international agreements outlawing bribery may provide some leverage in enforcing agreements with USAID to meet accountability objectives.

5. Coordination of Monitoring Activities with Other Donors and Other US Government Agencies

For accountability purposes, multiple donors and/or the presence of multiple US Government agencies providing assistance to address similar problems can create additional vulnerabilities to corruption. The most obvious is that poor planning or poor coordination can result in multiple payments for the same or similar activities. Another problem is that different donors may have different program or project priorities or may operate with different accountability standards. While each situation is different and may involve a different mix of donors and US Government participatory agencies, **coordination is critical to avoiding accountability problems**. As part of a meaningful accountability strategy, USAID should resist the temptation to go it alone.

Using the Central America and the Caribbean Emergency Disaster Recovery Fund (CACEDRF) as a constructive example, USAID met the challenge of coordinating its activities with those of other donors and other US Government agencies. Donor countries and recipient countries formed a Consultative Group for the Reconstruction and Transformation of Central America that at the least recognized the role of transparency and good governance in the reconstruction process (see discussion in the Honduras Case Study in Annex 3 of this report).

Active USAID participation in donor consultative or coordinating groups in situations requiring large amounts of aid from a variety of donors can provide a useful forum for arriving at agreements in principle with respect to accountability issues and should provide a forum for avoiding duplication of effort and funding. However, **donor consultative groups should be viewed as but one element of an overall USAID accountability strategy aimed only at addressing the specific vulnerabilities associated with major multiple donor situations**. Of equal importance, and applicable to all situations in which multiple donors are working in the same country to meet similar development objectives is the relatively obvious, but often

²⁹ The Inter-American Convention Against Corruption was adopted in 1996, subject to ratification by individual countries, and includes, *inter alia*, provisions that commit ratifying countries to develop mechanisms needed to prevent, detect, punish, and eradicate corruption., including the giving and receiving of bribes and transnational bribery.

overlooked, technique of **developing an internal reporting mechanism that regularly surveys other donors about the nature and extent of programs and projects and the monitoring status of each.** It is simply too easy to submit duplicate invoices to different donors for the same goods and services, and other like fraudulent practices, when the donors themselves operate in a mutual information vacuum.

Again with reference to CACEDRF, USAID took the lead in coordinating the efforts of US Government agencies responding to the disaster. Other than USAID, thirteen additional US departments and agencies received disaster recovery funds, eight of which were linked directly to USAID and many of which had limited experience working overseas. From the outset, USAID sought to incorporate the other agencies into its operational framework and largely succeeded in doing so, despite some complaints about the time it took to do so.³⁰ For purposes of this report, the most significant accountability impact of this approach is that the effort was made in the first place. While it should go without saying that the overseas operations of different US Government agencies operating to meet development objectives in the same country develop a coordinated accountability strategy, this is not always the case.

It bears noting that accountability issues related to both multiple donor and multiple US Government agency operations have the potential to be magnified by implementation of the MCA. Regardless of the ultimate decisions made regarding implementation procedures under the MCA, accountability for both USAID funds and MCA funds can be compromised in the absence of careful donor coordination, including specifically, careful coordination with existing and ongoing USAID programs and projects. Using CACEDRF as an example, USAID may be in the best position to ensure coordination to meet accountability objectives.

6. Establishing Sustained Substantive Anti-Corruption Programs and Projects in Recipient Countries

As discussed above, this report distinguishes between the *substance* of anti-corruption programs and projects and *methods* utilized to prevent or reduce corruption associated with the implementation of those anti-corruption programs and projects. This is not to say that sustained substantive anti-corruption programs and projects should not be considered as part of an accountability strategy. Rather, analytically in the context of a discussion about accountability issues as they relate to USAID development assistance, **there are elements of sustained anti-corruption programs that can contribute in the long term to an improved host country institutional capacity to enhance USAID's overall accountability strategy.**

Programs and projects that focus on developing financial institutions and monitoring bodies, that improve public administration, that train public sector auditors and accountants, that set government ethics standards and define conflicts of interest, that reform the procurement process, and that criminalize the elements of public corruption and train law enforcement personnel to investigate and prosecute these cases can eventually empower host country institutions to become effective partners in reducing corruption associated with development

³⁰ See March 21, 2001 Congressional testimony of Jess T. Ford, Director, International Affairs and Trade, GAO, "Implementing Disaster recovery Assistance in Latin America."

assistance programs and projects. Projects aimed at enhancing the institutional capacity of Supreme Audit Institutions and similar government institutions have been successful and should be included in accountability strategies with a substantive anti-corruption component. In fact, the OIG has a process that includes an assessment of institutional capacity, training to meet US standards, provisional approval and review, and ultimately approval to audit USAID programs and projects.³¹

In analyzing substantive anti-corruption programs and projects for their role in an accountability strategy, there are a couple of cautions that bear noting. First, one consistent problem with anti-corruption programs and projects is a tendency to accept legal change as a goal in itself without acknowledging that unimplemented legislation is no step forward. From an accountability perspective, having a nice procurement law that is not being implemented does not have any positive impact on the capacity of host country institutions to account for USAID funds expended on procurements. Second, without available and reliable information about government or organizational operations, efforts at accountability generally become little more than exercises in manipulation of suspect information. From a substantive program perspective, progress toward operational transparency may represent a measure of program success. From the accountability perspective, without full operational transparency, there is little or nothing to be gained from host country institution participation in USAID accountability efforts.

Establishing sustained substantive anti-corruption programs and projects as part of an accountability strategy can be viewed as an investment in future accountability strategies. Risk assessments for today's projects and programs can help guide development of substantive anti-corruption programs that will help build the capacity of host country institutions to meaningfully participate in tomorrow's accountability strategy.

³¹ As an example, in South Africa, this process led to a Memorandum of Understanding signed by the OIG, the USAID Mission Director and the Auditor General of South Africa. A similar agreement was reached with the Supreme Audit Institution in Indonesia in February 2001.

IV. CONCLUSION

As indicated in the Introduction, this report seeks to provide an analytical framework for evaluation of accountability techniques and methods. The result of application of that framework should be a practical and effective accountability strategy for each significant program or project. The analytical process is the same for programs and projects that involve infusion of large amounts of assistance in response to disaster, emergency or agreement and those that involve routine delivery of development assistance.

The process starts with a recognition of the factors that create vulnerability to corruption in general. A meaningful risk assessment then narrows the focus to the vulnerabilities present within a specific environment. It is impossible to overstate the value of a solid risk assessment in determining the appropriate strategy to address the risks. Coincident with the risk assessment and just as fundamental to the process is an early and clear commitment to accountability as a program or project priority.

With accountability as a priority and a risk assessment in hand, review of the available techniques and methods to reduce corruption can focus on specific identified vulnerabilities and the resources available to implement an accountability strategy. **It is important to remember that a successful accountability strategy is likely to embrace a range of practical responses.**

Development of an accountability strategy requires certain steps:

- Management commitment
- Risk assessment
- Determination of an appropriate package of auditing and monitoring tools to meet accountability needs
- Determination of steps to be taken to ensure implementer adherence to strict financial management guidelines
- Determinations regarding the need for donor and USG coordination
- Design targeted substantive anti-corruption programs and projects to improve host country institutional participation in accountability responsibilities.

Following these steps and the resulting accountability strategies give practical content to the critical factors in addressing corruption concerns enumerated by OIG representatives (page 14 *infra*). That both USAID management and the OIG seem to be committed to roughly the same principles and procedures is an extremely significant development in meeting USAID accountability obligations. The key to continuing progress is a continuing commitment to development and application of effective techniques and methods designed to reduce corruption and promote accountability.

The techniques and methods discussed in this report, while not intended to be exhaustive, are at the core of the techniques and methods that USAID has been successfully utilizing in recent years to reduce corruption in its programs and projects. Making organization of these techniques and methods into an effective accountability strategy for each program and project a routine matter is still a challenge. Despite this, the now emerging experience and expertise with application of accountability strategies that work gives USAID a competitive advantage in meeting corruption concerns associated with the MCA or other development assistance alternatives. As importantly, the implementation of effective accountability strategies helps to ensure that USAID programs and projects maximize their substantive potential.

Annex 3 – Country Case Studies

BOSNIA & HERZEGOVINA CASE STUDY

CONTEXT

The Ramp-up in Bosnia-Herzegovina was a product of the 4 year Bosnian war and the 1995 Dayton Peace Accords. It was a response to the humanitarian needs of a war-devastated population and the political-economic challenge of a country in transition from communism and command economy to democracy and free market economy. The ramp-up started with the end of the war in 1995 and remained at a high level for several years. The initial tranche of USG development assistance after the Peace Accord was signed was \$232 million with \$248 million in the following year. Overall during 1996-99, the US and international community committed more than \$5 billion.

BiH is something of a special case because the Office of the High Representative (OHR), with government oversight responsibilities, oversees the implementation of the terms of the Peace Accord. The OHR reports to the Peace Implementation Council (PIC). Over the years, the PIC expanded the powers of the OHR in response to the intractable political stalemate that delayed and obstructed development in BiH. So, in Bi-H we have a situation in which there is greater scope for influencing policy at the highest level. However, the job of helping with the transition is not much less challenging and frustrating than in other transition countries and there is the added complexity of persistent ethnic tensions and the impact of the war on the fabric of the nation. The USG is providing assistance in judicial reform, law enforcement, legislative and regulatory reform, economic reform, financial accountability, civil society development, independent media development and public awareness.

CORRUPTION

As reported in AMEMBASSY SARAJEVO 802212211 (August 02, 2002), "corruption in Bosnia remains deeply rooted and is the focus of extensive efforts by the international community. Progress has been slow for lack of political will...and [lack of] an effective criminal justice system..." The reform is seen as still in its infancy yet corruption is helping to sustain hard line nationalist political machines and discourages domestic and international investors. The OHR has declared anti-corruption one of its highest objectives and the USAID program has been an important cornerstone of this policy from the beginning.

QUESTIONS

A. Did corruption become noticeably more of a problem with the ramp- up? Was there more ability to address corruption because of the ramp-up? What, if any, anti-corruption initiatives were underway before the ramp-up in assistance began?

In Bosnia there was concern for corruption from the outset because of the black market that developed owing to sanctions, a war economy and due to the usual panoply of corruption from communist times. However, the first wave of assistance was humanitarian relief provided through USAID's Office of Foreign Disaster Assistance, Food for Peace and other humanitarian relief organizations.

When USAID's Bureau for Europe and Newly Independent States (ENI) program was developed, they knew corruption would be a problem and determined not to move money through the government. The US Administration's commitment of \$500 million in balance of payments was

noted in the government's (GOBiH) ledgers and then immediately transferred to the USAID for implementation. The entire amount was implemented by USAID. There were so many locks and safeguards put on that it had to be one of the most corruption free programs. The USAID Mission Director at the time of the ramp-up, Craig Buck, took very deliberate measures to protect US taxpayers' money.

In some cases, where money was diverted, it was found through audits and restored. This contrasts with the EU, which lost reportedly hundreds of millions in the early stages, according to a New York Times article never refuted by the EU. The EU ran its money through the government and had a very small staff to oversee its funds.

The USG did provide budget support to the Republika of Srpska. This was done in three tranches, \$20-25 million over 3 years for health workers, teachers and pensions. This was audited concurrently.

B. What did USAID do to minimize or counteract corruption in connection with rapidly increased assistance in this country? Describe the activities and their results. What lessons were learned?

Look for the greatest source of graft at the outset and try to neutralize that source. The Payments Bureau, and official arm of government, was in effect the Nationalist Party financial clearing house. Its operation was the source of many illicit transactions and its dominance was damping the emergence of a banking sector. USAID worked hard to get that Bureau eliminated and eventually succeeded. This was the beginning of the emergence of an honest banking system in Bi-H.

Projectized assistance with open and transparent bidding process. The Mission avoided running money through the government. Whenever possible, run the money through projects. For example, in the early days USAID ran a large municipal infrastructure program to repair war-damaged infrastructure. USAID awarded the contract to Parsons who in turn competed the projects for local contractors; the projects were announced in the papers, bids were reviewed and results announced in the papers.

Running money through the government just opens the door to corruption. USAID, for the most part, did not. The EU and other donors who did, lost heavily.

Background checks. USAID ran a Business Development Program that involved loans and grants to businesses. Due to the Lautenberg Amendment (to assure that US funds don't go to municipalities where leaders work to subvert Dayton or to people who are publicly indicted war criminals or to people who protect war criminals anyone who received money from USAID, e.g., through the loan activity under this program, had to be given a background check which could take up to 6 to 8 months. This applied to anyone receiving a loan, contract or traveling out for a participant training trip overseas..

Personal follow through on projects. USAID ran a local "gum shoe" operation to make sure people were using USAID money for the purposes intended -- even into checking that the proposed ethnic balance that loan recipients said existed in the work force was in fact true. Local people were hired to do this checking and they even checked market prices of goods being bought by loan recipient companies to be certain the price quoted in the loan documentation was a market rate.

Assure the middle class through program rationality and follow-through on corruption. The Mission didn't want to lose credibility with the middle class, whose confidence was important to the overall recovery program. That is, the Mission didn't want to be seen as an organization that just handed out money. There had to be rationality and integrity to the program and follow through on transgressions. Probably not all violators were caught, but in all it was a very effective system. When people were caught, they were brought to justice.

Staff up for the effort. It is important to remember that to run a tight program in these circumstances, to do the kinds of things just mentioned above, you have to have the resources. For example, the Mission had some 200 to 300 people, including contractors, etc. The ramp-up made it possible to apply a significant amount of effort to control and monitoring. Plus, many of the early contractors were major audit and banking and finance firms.

Lessons learned:

1. There is a need for a massive public information campaign and a Public Information Officer. Mission's need to get as much process out there as possible and encourage "whistle blowing" if corruption is observed. Get the information out and allow a commentary period. This is especially important when programs encounter the issue of property ownership. That is, who owns the building or land involved in rehab or development program. Of course, publicizing everything puts people at the risk of the Mafia. One gets a loan and soon is visited by the Mafia to get a cut. So transparency is recommended, but with prudence. For example, do you publish the names of boards of directors? Or how much the loan is that is being sought?
2. Don't do programs through the government (run money through) when that government is in transition and where there is political volatility, such as there is following a war. A July 2000 GAO report noted that "the international community has provided \$407 million in budget support to cover Bosnia's budget deficits, and most of this support is not controlled or audited."
3. Hire follow-up people to check on end uses, compliance, beneficiaries, etc. Follow through with legal actions when violations are found.
4. Set aside adequate resources for staffing. How much depends on the nature of the ramp-up.
5. Place political and ethical conditionality on the assistance. The World Bank and European Union tend not to do that, which, of course, puts negative pressure on USAID.

C. Are there any new anti-corruption activities planned as a result of this experience?

The Mission is taking a hard look at the judicial system and plans a judicial assessment this February. The High Representative has made judicial reform his top priority under his tenure.

The framework for the new market economy should bring about Sunshine Laws. This is still a work in progress. The Mission is gradually chipping away at this problem. It takes time.

There are several projects, which while not addressing corruption directly should have a significant impact, and reportedly all are making good progress. These are:

- Private Sector Accounting.
- Public Sector Accounting Reform.
- Tax Administration Modernization.

- Corporate Governance and Business Investment.

All these projects are meant to bring Bi-H institutions up to international standards of accounting, financial management and ethics.

D. Are there particular areas of vulnerability for corruption in USAID activities in this country? In host country operations?

Budget support always is an area of vulnerability. USAID kept this to a minimum and when done, applied concurrent audits to see that these finds were not skimmed off. See above.

Work with the police can be tricky. Recently Police working for a US contractor working for an agency of the USG were found to be running houses of prostitution, allegedly used by the western community. The company personnel involved were sent home and the police officers involved can't work for that company anymore. This mild discipline on both sides coupled with western complicity serves to undermine anti-corruption efforts, especially with the general public.

Privatization is an area of vulnerability. The BI-H program, assisted by USAID, was conducted through a convoluted and difficult weighing of the number of vouchers due to citizens of BiH which included not only the normal approach to voucher privatization but also included in the equation weighing of such things as length of military service, disabilities, and other factors directly related to the war. Number of vouchers was based on days served plus dependents and nature of losses. The vulnerability here, despite the safeguards USAID imposed, was inflation and graft in reporting on any of the above qualifying factors, given the huge logistical and administrative burden a program of this nature presents. Foot dragging by the political leadership to move on the privatization of companies that were deemed either sensitive or critical industries despite international pressure to move rapidly on them caused the , the US Ambassador to cancel the US technical assistance to privatization process. He did this to make a public point about official foot dragging and game playing on privatization. Actually, the US contract was at its completion date when the program was terminated, but this was not public knowledge at the time of the Ambassador's cancellation

E. Are there IG activities, audits or TA, that should be noted?

The Mission requested audits on several occasions. When the New York Times article on EU losses came out (see above), the General Accounting Office in mid-2000 was asked by Congress to examine the US program as well as others. The USAID programs were found to be corruption free, except that in 1998 a USAID FSN was terminated for receiving payments for helping a USAID loan applicant. Other GAO audits were conducted in 97 and 98 on the pace of implementation of the Peace Accord.

F. Cooperation with other donors

1. What kind of collaboration is there between donors, including USAID, on corruption issues?

International coordination is the responsibility of the High Representative. That office was given very little authority to effect coordination in the Peace Accord. In later years, this flaw was corrected and the High Representative now has much improved authority for coordination of donor assistance. The current HR, Paddy Ashdown, has made Rule of Law a central feature of his agenda and this will be reflected in donor programs. He has initiated a high profile anti-

corruption campaign that gained some teeth when he sacked two finance ministers for corrupt activities.

As to coordination within the US program, in the early stages under the humanitarian relief program, there was a feeling of close teamwork among USG agencies. After that phase of operations, turf became more of an issue as US agencies vie for budget under SEEDS coordination. USAID notes the lack of information sharing between agencies and inability to get information from Justice, Commerce and Treasury.

2. Have other donors had particular problems with fraud or corruption?

EU has had problems (see above). The World Bank suffered some losses.

G. Did USAID work with any NGOs on anti-corruption in this country?

NGOs are a major part of the USAID program to foster civil society and these NGOs work on transparency and accountability issues and recently some have received grants to work on trafficking in women.

NDI ran a USAID program in which it sponsored community level discussions on the basic tenets of a democracy. Some of these groups became NGOs and work on promotion of transparency, accountability, openness and participation, among other things.

H. Anticorruption recommendations for Missions about to undergo a significant ramp-up of assistance.

- ❑ Look for the major obstacles to progress with reform and anti-corruption, e.g., in BiH it was the Payments Bureau.
- ❑ If the international community is putting in the equivalent of the High Representative in BiH, make sure that office has effective coordination authority with respect to other donors.
- ❑ Do a quick assessment to see what is needed to move quickly on establishing rule of law and a court system people can trust.
- ❑ Make public information and awareness campaigns a major element of anticorruption work. Do as much as you can at the grass roots level. Promote massive education campaign at the grass roots level.
- ❑ Practice what you preach.
- ❑ Get involved in the education. Bring the next generation along with enlightened education. This will sustain US efforts at reform. In BiH the schools were using the same textbooks as they had under the Communist system.
- ❑ Don't assume those in opposition to bad leaders will automatically emerge as the democrats and as effective leaders. The GAO reports that in BiH the "wartime underground networks have turned into political criminal networks involved in massive smuggling, tax evasion, and trafficking in women and stolen cars." (GAO July 19, 2000)

EGYPT CASE STUDY

CONTEXT

Egypt is a special case in this study in that the ramp-up occurred so long ago and under circumstances with which all who read this will be familiar. The program reached a level of roughly one billion dollars per year beginning after the Camp David Peace accords in 1979 and has held at somewhere close to that level since that time. It is too long ago to trace the circumstances in the Mission at the time of the ramp-up. However, the Egypt program is so large and diverse that we felt it could teach us something about managing large aid flows in a highly corrupt environment.

Egypt should be seen as a country in transition from a command economy to a more market oriented system. USAID has been a champion of this transition, and as such, is subject to some of the same problems and successes that accompany transitions elsewhere.

This case is based on USAID and State Department documents plus an interview with Dr. Abdel Moustafa, who worked for many years as an activity manager in the USAID Mission in Egypt and is currently USAID Desk Officer for Jordan.

CORRUPTION

Petty corruption in Egypt is for all practical purposes older than the pyramids. Nationalization under Nasir only exacerbated the situation, greatly increasing opportunities for rent seeking and other forms of graft. This is the context in which USAID had to manage the huge Egypt program. Today, according to AMEMBASSY CAIRO 7700 (August 1, 2002), corruption has escalated to higher levels and includes managers of public sector companies, members of parliament and wealthy businessmen.

QUESTIONS

A. Is corruption more or less of a problem as a result of the huge US aid program in Egypt?

Corruption was a problem only from the standpoint of the pure size of the program. Corruption is a big problem in Egypt and will remain so as long as the cost of living so drastically exceeds average salary levels of officials.

There are also some unusual social-economic circumstances. For example, in the key sector of housing, rents have been capped from the time of Nasser and remain so today, such that rents are just about on a par with landlord taxes.

Abdel Moustafa thinks the mission is gaining on corruption because of progress with the market economy being promoted by the Mission and others. Egypt had a peri-command economy in the 60's and 70s. In 1963, the ways and means of production was nationalized, including banks. Corruption was largely a function of regulation of the economic system. Since that time, the economy and government have been in a phase of gradual transition. Just this month, there were discussions of privatization.

This transition started in the 70's after the 1973 war. Activity picked up with Camp David in 1979. Actions were taken then to privatize the Egyptian economy. However, is a work in

progress. For example, even now, Egypt has the largest state owned textile factory in the world, with some 200,000 to 300,000 employees.

The country is discovering that government needs to get out of the banking system and that labor laws need adjustment. There are several hundred thousand young people going into the labor market every year. A vibrant free market economy is needed to cope with this influx.

There is progress on the economic liberalization front. The food subsidy system is now practically non-existent. Public transportation is now largely in private hands. The competition these changes introduce eliminates opportunities for corruption.

CAIRO 7700 supports Moustafa's point about the impact of economic liberalization on reduction of corruption. USAID efforts to "remove regulatory conditions that create an environment for corruption is one of the most effective and sustainable ways to reduce systemic corruption."

The State Department cable also notes that anti-corruption efforts in Egypt have picked up dramatically in Egypt in the past two years. "The number of corruption cases and convictions has gone up dramatically. Several high level officials -- including ex-Ministers -- have been tried and convicted of corruption." This new emphasis on combating corruption is credited largely to the work of the current Public Prosecutor and the Administrative Control Authority Chief. USAID is given credit for assisting with this work through its programs that emphasize "the use of good governance tools that promote transparency and accountability."

B. What did USAID do to minimize or counteract corruption in connection with high levels of assistance in Egypt? Describe the activities and their results. What lessons were learned?

Pre-Project Implementation Conferences. The Mission has initiated the concept of Pre Project Implementation Conferences for all new projects. These conferences are organized by the Controller's office and include a SWAT team that involves representatives from the Controller's Office, Procurement Office, Management Office, and sometimes a representative from the IG to explain their audit procedures and other concerns. These week long off site conferences involve all key project implementers and about a dozen trainers. Egyptian counterparts are given an important role in organizing and managing the conference.

The idea is to minimize problems that would require an audit. Participants are instructed in and discuss: channels of communication; how USAID programs are implemented; areas of accountability; areas of vulnerability and potential for corruption. Comprehensive manuals in English and Arabic are handed out and discussed. Counterparts are given an orientation on how to eliminate most of the potential for corruption.

At the end, all participants (including private sector participants) know how things are done and understand their accountability. In some cases, the counterparts, central and local government, actually run the conference to give them a better sense of ownership of the process and contents.

Policy and Governance Programs. USAID also is working on corruption issues in the larger societal sense. The USAID Administration of Justice program, Economic Growth Programs and work with local government and NGOs on institutional efficiency, accountability and transparency all help to reduce the prospects and opportunities for corruption.

Results. With a few notable exceptions (see below) most audit report findings and questions have been answerable and many were found to be just a product of misunderstandings. Also, as noted

above, in the past two years, there has been a dramatic increase in Egyptian anti-corruption measures and these are supported by USAID programs. For example, through the USAID Administration of Justice Project and computerization of the judiciary, opportunities for corruption in the courts are being reduced, e.g., undermining the practice of "judge shopping" by random computerized assignment of judges.

The State cable reports that there have been changes in oversight of the financial and capital market to reduce opportunities for fraud and insider dealing. An investigation has resulted in resignation of one prominent banker in an insider trading scandal. Egyptian Banks have been instructed by the central bank to adopt international accounting standards.

Further, Moustafa reports that there seems to be a general understanding among Egyptians that there is in the USG and USAID a high intolerance for corruption such that USAID is seen by Egyptians as the least corrupted and most efficient donor. This helps make USAID resources less vulnerable than some other donor programs.

C. Are there any new anti-corruption activities planned as a result of this experience?

The Pre-Project Conference program will be continued along with those programs that reduce corruption even while not addressing the corruption problem directly. These programs address the following strategic objectives:

263-021 Egyptian Initiatives in Governance and Participation Strengthened
263-016 Environment for Trade and Investment Strengthened

D. Are there particular areas of vulnerability for corruption in USAID activities in this country?

Large infrastructure projects are vulnerable and need highly skilled oversight and honest implementers. The kind of bid rigging in infrastructure that was uncovered by USAID and the IG and resulted in over \$200 million in penalties is something that must be guarded against.

Sometimes there is a tendency to go back to the same individuals or institutions as counterparts and implementers, because there is a comfort level involving familiarity, US advanced education and fluency in English. This can result in burn out for the repeaters and resentment among the outsiders who may be equally well qualified. There is a need to break through the language barrier and more actively seek out qualified individuals and institutions that have been neglected to date. This will also help alleviate some of the tensions and anger that build up over aid allocations.

E. Are there IG activities, audits or TA, that should be noted?

See above re participation in Pre Project Conferences and the big case with over 200 million in claims.

F. Did USAID work with any NGOs on anti-corruption in this country?

USAID has an NGO Service Center activity that helps to strengthen NGOs in terms of improving their own institutional integrity and capacity to heighten public awareness of the importance of transparency and accountability.

G. What anti-corruption recommendations would you make to Missions about to undergo a significant ramp-up of assistance?

- ❑ Since 9/11 missions should do projects to win the hearts and minds of the people. In this context, the huge commodity import program, keyed to businesses, could be broadened to reach more of the Egyptian population. For example, the water and sanitation projects in Cairo and Alexandria have made a huge difference in the quality of life. In Cairo and Alexandria they used to build dikes around commercial areas to hold back pollution. Off the shores of Alexandria, the Mediterranean Sea used to be gray. Now it is clear. The agricultural production system is about 90% transformed in terms of the quality, quantity and variety of production. The telecom and water and sewer sectors have been nearly 100% corrected. This is all a result of USAID programs.
- ❑ Put money into projects (as opposed to budget support).
- ❑ Provide more monitoring.
- ❑ Adopt the pre-project conference approach for large projects.

GEORGIA CASE STUDY

CONTEXT

USAID attempted a transition program in Georgia that saw a substantial increase in USG assistance in 1993. However, this was followed by a period of violence and instability ending around 1995. At that point Georgia began to settle down to political stability and the task of democratization and reform. This eventually was met with a substantial ramp-up in USG and USAID assistance in 1998 that has continued through to the present. Reform showing encouraging promise was initiated in the areas of privatization, banking restructuring, the judiciary, health care and regulatory policies. However, progress is impeded by weak institutional capacity, wavering political will to implement reforms and rampant corruption.

CORRUPTION

The Government has taken some useful steps, and USAID and other USG entities have launched programs aimed at corruption, achieving some level of success. Nonetheless, corruption in Georgia remains a significant and widespread problem.

The culture of corruption runs deep in Georgian society. For hundreds of years the Georgians have been overrun by one conquering group after another -- Communist Russia being only the latest in a long line. Georgians have seen corruption as a means of dealing with the conquerors and as an economic survival strategy. As such, it pervades all levels of society and is seen as normal and perhaps even in some historical sense noble. AMEMBASSY TBLISI 2860 of September 16, 2002, reports that "USG efforts to support anti-corruption in Georgia have been significant and enjoyed some success; however, the nature and pervasive extent of GOG and societal corruption preclude a quick fix. The Embassy continues to be especially concerned about the Procuracy's failure to bring any corruption cases to trial, the widespread, intransigent corruption in the Customs Service, and social perceptions and tolerance of corruption in Georgian society at large." Official corruption seems to be undermining public trust in government despite the general culture of corruption that persists.

One hopeful sign is that last June mayoral elections were held for the first time and the turnout was 60%. This suggests a not immodest interest in local governance on the part of the citizenry. This interest must now be sustained and directed also at the corruption issue. Transferring authority to the local level is a positive step as there is reportedly less corruption at the local than at the national level. This may be an opportunity through citizen pressure to eliminate some sources of corruption.

QUESTIONS

A. Did corruption become noticeably more of a problem with the ramp- up? What, if any, anti-corruption initiatives were underway before the ramp-up in assistance began?

There does not seem to be a correlation between USAID assistance and corruption. Georgia has been a tremendously corrupt country and has been for hundreds of years. It has been invaded many times and corruption was seen by Georgians as a way of milking their masters and a way of survival. Communism only exacerbated this endemic and cultural corruption. Under the oligarchy in power corruption has probably increased. But, USAID has kept very tight reins on its resources.

The Mission is working on corruption through the administrative code and through all of its programs. However, corruption in Georgia is like a ball of twine being unwrapped. Donors are only working on the outer layers.

The ramp-up gave the mission more ability to fight corruption. They were able to hire better TA for longer periods and to work on the administrative code. The Mission couldn't be doing this without additional funding. Over time the Mission's work will have an impact.

A key is not letting your program feed into the streams of corruption.

There was nothing in the way of anti-corruption work going on before the ramp-up.

B. What did USAID do to minimize or counteract corruption in connection with rapidly increased assistance in this country? Describe the activities and their results. What lessons were learned?

The Mission chose its programs very carefully to avoid programs that would be vulnerable to corruption. Programs were tightly managed and monitored very closely. Anti-corruption measures are built into virtually all of USAID's programs. Audits were used aggressively as a deterrent. Audit activity continues to the present, and there have been at least three significant audits in the last year and a half, none of which turned up major problems. In addition, the Mission launched some specific anti-corruption activities since the ramp-up began. These include:

- ❑ *Provision of TA to the special anti-corruption commission, in cooperation with the US Department of Justice.* So far results have been modest. The president directed government ministries to implement the 13 recommendations developed by the Commission and an Anti-Corruption Coordinating Council consisting half of civil society representatives has been established and meets regularly. One of the 13 recommendations called for elimination of 44 traffic check points that were not needed and were a great source of bribe taking and extortion. In the end only 27 were eliminated. DOJ is applying pressure on the Commission to perform and this too appears to be producing some results.
- ❑ *Development of the first comprehensive judicial testing system.* Results are encouraging. So far 93% of the judges have passed the test and some on the Supreme court who did not pass were removed. Reportedly, people seem more willing now to bring their cases to the courts. Also, pro-bono consultations by USAID assisted legal NGOs have increased from around 4,000 to about 17,000, helping people to defend and enforce their legal rights.
- ❑ *Assisting the government in development of an administrative code that includes freedom of information and other anti-corruption tools.* This is the most progressive administrative law code in Eurasia. It includes a legal point of entry for the public into the government's decision making. USAID also gives grants to watchdog NGOs to track national and local government agency's performance under the new code. The code calls for open meetings and meetings are supposed to be announced and open to the public. There is evidence of increasing local level transparency, especially in three of the five pilot cities in which USAID is providing local government assistance.
- ❑ *The administrative law code cuts across all other USAID programs, e.g., in energy reform, banking reform, parliamentary reform and local government.*
- ❑ *Mobilization of civil society, including advocacy NGOs and the media.* Some Georgian NGOs have reported on misuse of power and authority by GOG officials. For example, the Democratic Meskhs Union (DMU) published a bulletin explaining about abuse of power in clear and concise language, drawing on the new Administrative Code's provisions.

- ❑ *Funding the ABA-CEELI for its Rule of Law program.* This includes helping to develop a Code of Ethics for newly appointed judges, developing a bar examination for lawyers, initiating training for auditors and inspectors working on criminal cases and planning with the Council of Europe and others to discuss compliance with the European Convention.

Lessons Learned:

When a government lacks strong political will, progress is very slow and incremental but it is important to build on and reinforce this progress.

It will be difficult to resolve the corruption problem in Georgia without convincing the public that solving the problem begins with each individual. Corruption in Georgia is not going away any time soon. It is a time honored survival mechanism. For change to take place there has to be a mind shift -- a cultural shift. This has to be an important element of new anticorruption programs.

Administrative law reform is a good cornerstone for an anticorruption program because it affects virtually everything else by providing appropriate standards for legal implementation.

C. Are there any new anti-corruption activities planned as a result of this experience?

The Mission is in the middle of drafting a new overall strategy. In addition to USAID's programs, anticorruption activities have been initiated by the Department of Justice (law enforcement); Treasury (customs and tax ethics); State INL (forensics, police ethics, lawfulness training, ABA-CEELI, criminal audits and inspection); and Commerce (business ethics).

All mission programs are feeding into people level impact. The Mission also is working specifically on bringing about a basic cultural shift through the IRIS program. IRIS is doing public service announcements (PSAs) through the media -- TV, etc. They don't pay for airtime. The PAs that are being developed are based on focus groups held all over the country to discover what is on people's minds and what would resonate. This new \$2.5 million per year IRIS program focuses on promoting: public service announcements, open meetings and transparency

D. Are there particular areas of vulnerability for corruption in USAID activities in this country?

Familial and ethnic cronyism is a serious element in Georgian corruption.

Small grants are vulnerable, but because of this they are very carefully monitored, controlled and audited. As a result there has been little evidence of problems.

The political realm can be a risky area for assistance. The Mission made resources such as computers and fax machines available to the Central Election Commission some years ago and there was much loss. The Mission is not dealing with this organization again. On the other hand, the Mission gave computers to the MOJ and recent checks have revealed that all computers are in use.

E. Are there IG activities, audits or TA, that should be noted?

Not aware of any audits or IG activities of note. There was a problem with missing computers under a Eurasia Foundation grant. The losses were discovered and the grantee made restitution.

F. Cooperation with other donors

1. What kind of collaboration is there between donors, including USAID, on corruption issues?

There is excellent coordination and cooperation among donors. There are regularly scheduled meetings, duplication is avoided and there is sharing of training venues. Georgia is a small country with a small donor community. All face similar problems and coordination and cooperation takes place in a positive and willing atmosphere.

Given the involvement of many USG agencies in fighting corruption, the Embassy has established a Law Enforcement and Anticorruption working group. This group is chaired by the DCM and includes the political/economic counselor, the regional security officer and representatives from programs of USAID, Justice and their implementing partners.

An encouraging example of coordination within the US program is in the area of public information. The DOJ is going to work together with USAID partners on Public Service Announcements (PSAs). This collaboration involves USAID media, civil society and rule of law programs and partners IRIS, NDI, IREX and Save the Children.

2. Have other donors had particular problems with fraud or corruption?

Some, like EU and WB are wondering whether corruption is in part a by-product of their programs. EU and WB have had more problems than USAID, but all the donors complain about corruption..

3. Is this country signatory to any international conventions on corruption?

Yes, Georgia has signed on to most of them in order to join the Council of Europe, but this seems to have made little difference so far. No strong commitment; public and international relations seem more of a motivation.

G. Did USAID work with any NGOs on anti-corruption in this country?

USAID worked with an NGO to help develop the first judicial testing system for qualification of judges. Also, USAID's anticorruption strategy involves mobilizing civil society, including NGOs and the media. See above on PSAs and the new IRIS program -- both of which involve NGOs.

H. What are the anti-corruption recommendations for Missions about to undergo a significant ramp-up of assistance?

- ❑ Citizen awareness and advocacy is critical. First, citizens need to know that every time they pay a bribe they are reinforcing the system. In countries with a culture of corruption it will not be until the public realizes that corruption is an individual as well as a governmental problem, that corruption can be defeated. One idea that might bring this to public attention is to have a "no bribes day." Second, citizen pressure is needed to give leaders the political will to enforce anticorruption reforms.
- ❑ Reforming laws in order to eliminate some forms of corruption is necessary, but meaningless unless the law also is enforced. However, sometimes effective enforcement requires that citizens be well informed about their rights and responsibilities under the law and coached on how to stand up for those rights.

- ❑ Administrative law code is a good place to start the reform process as it affects many facets of governance.
- ❑ Avoid high risk areas of cooperation, such as work with organizations that have a political focus. Once an organization has shown itself to be untrustworthy, don't go back.
- ❑ It is easy for the general public and parts of the government to misunderstand the nature of USAID assistance, and that USAID money does not go into funding the government. It is worth making this clear to avoid criticism and loss of credibility.

HONDURAS CASE STUDY

CONTEXT

1. Nature of ramp-up.

In 1998, Honduras was making significant progress in addressing development challenges. USAID assistance in 1998 was approximately \$20 million. In October 1998, Hurricane Mitch devastated Honduras, causing destruction of infrastructure and huge economic loss. Following the hurricane, a special supplemental appropriation for hurricane relief boosted the 1999 USAID program to \$290 million. The bulk of the hurricane reconstruction program was completed by the end of 2001. In 2002 the assistance program was about \$38 million, and about the same has been requested for 2003.

2. Corruption problem

Corruption has been and is a serious problem in Honduras. The judicial system is particularly weak, with little capacity to stem fraud and corruption through normal judicial channels and a history of allegations of serious corruption at all levels. The WB Governance Indicators rank Honduras in the bottom quartile in terms of control of graft and respect for the rule of law. The Global Competitiveness Report says bribery is more pervasive in Honduras than in other CA countries.

QUESTIONS

A. Did corruption become noticeably more of a problem with the ramp-up?

The supplemental appropriation for hurricane relief was \$621 million (not all USAID, not all Honduras). The size of the appropriation, combined with the urgent need for quick action, created a situation where anticorruption was a significant concern. Corruption surrounding use of funds had to be controlled. Failures of control could mean that the funds would not be as effective, reconstruction would be slower, possibly even destabilizing if there was seen to be widespread misuse of relief funds.

Was there more ability to address corruption because of the ramp-up?

There was money set aside within the appropriation for monitoring, auditing, etc. -- \$5.5 million for USAID monitoring, \$1.5 million for IGO oversight.

What, if any, anticorruption initiatives were underway before the ramp-up in assistance began?

USAID had been working on Rule of Law projects for several years, especially reform of the Code of Criminal Procedure and judiciary improvement. Honduras signed the OAS Inter-American Convention Against Corruption and had begun to implement improved financial management and auditing procedures promoted by the AAA project.

B. What did USAID do to minimize or counteract corruption in connection with rapidly increased assistance in this country? Describe the activities and their results.

1. *Donor Consultative Group.* Donor countries and affected countries formed a Consultative Group for the Reconstruction and Transformation of Central America. Participants included major donors and leaders of affected Central American governments. The DCG committed to

Goals and Principles governing the reconstruction (the Stockholm Declaration). The Declaration had a substantial anticorruption component, including:

- Reconstruct and transform Central America on the basis of an integrated approach of transparency and good governance.
- Consolidate democracy and good governance, reinforcing the process of decentralization of governmental functions and powers, with active participation of civil society.
- Promote respect for human rights as a permanent objective. The promotion of equality between women and men, rights of children, of ethnic groups and other minorities should be given special attention.

2. *USAID Special Objective: Improved GOH reconstruction accountability and transparency.* USAID assisted with the transparent and accountable use of reconstruction funds “by supporting establishment of independent oversight mechanisms for Honduran Government implementing agencies, strengthening the capacity of the Honduran Controller General, strengthening the monitoring capability of civil society, financing external RIG audits, fortifying internal USAID oversight capacity and supporting accountability and transparency activities at the municipal level.” The President of Honduras, by Executive Decree (No. 018-98), directed the Comptroller General of the Republic (CGR) to name special commissions to monitor assistance received. At the request of the CGR, the USAID Controller’s office worked with the CGR to monitor all assistance. The CGR also contracted with an internationally recognized accounting firm to supplement its own staff in the monitoring effort.

3. *OIG Proactive Measures.* OIG oversight included proactive measures to prevent and deter misuse of funds. The OIG:

- Educated USAID staff, grantees and contractors about fraud and fraud awareness, emphasizing the responsibility to report evidence of fraud and corruption.
- Helped USAID design activities to minimize the risk of fraud and corruption.
- Worked with USAID partners to establish appropriate fraud prevention policies regarding financial disclosure, ethics, employee conduct and fraud reporting.
- Evaluated internal controls established by USAID, contractors and grantees.
- Assisted USAID with monitoring, by, for example, helping draft SOWs for certain accounting procedures. OIG also alerted USAID management to impending problems.

4. *OIG Audit and Investigations.* The OIG performed risk assessments of each activity financed under the supplemental appropriation. Higher risk activities were subjected to concurrent financial statement audits.¹ Lower risk activities received annual financial statement audits. All activities were covered by performance audits.

Results

There’s been a huge amount of international assistance and attention to Honduras since the hurricane, including a lot of attention to anticorruption and better governance. (USAID has worked on Rule of Law, transparency, accountability; WB on anticorruption; IADB on government reform; Spain on justice). Has it made a difference?

The perception of Honduras as a country plagued with corruption continues. The WBI diagnostic survey of corruption in Honduras found that public officials and enterprises say that corruption has been a serious problem over the last five years and it hasn’t gotten any better. Some,

¹ Concurrent audits differ from annual financial statement audits in that audit work is done throughout the year and quarterly audit reports are required.

especially enterprises, say the situation is worse today than five years ago. However, there are islands of change, and perhaps a movement towards serious reform, that could be attributable to the assistance that Honduras has received.

- Reforms in Rule of Law have moved forward – major reform of criminal procedures code.
- In 2000, a constitutional amendment was passed to reduce politicization in appointments to the Supreme Court.
- Civil society was active in pressing for the constitutional amendment, and for secondary legislation, including a law requiring board nomination of Supreme Court magistrates.
- Civil society was also involved in preparation of the PRSP. Transparency and anticorruption issues were incorporated into the strategy.
- Supreme Audit Institution is capable of carrying out audits up to USG standards; has signed a MOU with OIG and USAID.
- Public Ministry (headed by attorney general) is a force for change, provides leadership in anticorruption. Some prosecutions. Has “challenged previously untouchable sectors of society.” (2002 Activity Data Sheet on Rule of Law). Also FY 2000 overview mentions this: Public Ministry has been “an effective force against corruption and impunity.” There have been cases against high level civilian and military officials. Anticorruption efforts continue, and the present AG has stated that this is a priority for the Public Ministry.
- Newly elected National Party president, Ricardo Maduro, ran on a platform that had similarities to the Stockholm Principles. He is a successful businessman and former president of the Central Bank of Honduras. (In the WB survey of corruption in Honduras, the Central Bank was perceived as one of the least corrupt government entities.)

Improvements noted in World Bank study of corruption in Honduras.²

- GOH’s transparent and fair distribution of humanitarian aid helped rebuild community trust in government officials.
- Government and civil society have been increasingly concerned with quality of governance and lack of transparency. Improved governance and greater transparency became key priorities in the government’s development agenda.
- The Office of the Comptroller and the Office of Administrative Probity has been strengthened.
- Standard bidding documents for public works have been developed.
- Integrated financial management system has been expanded throughout the public sector, increasing the transparency of the budget process and financial management.
- Before the election, presidential candidates committed that whoever won the election would implement a long-term vision plan for the country (the National Agreement of Transformation for the Human Development of the XXI Century), which includes security improvements, gender equity, reduction of poverty, elimination of corruption, consolidation of human rights, an improved education system and stronger democracy.
- The GOH requested WB assistance in designing an integrated strategy to fight corruption and promote good governance.

² World Bank Institute. 2002. *Governance and Anti-Corruption in Honduras: An Input for Action Planning*. (Draft of Jan. 9, 2002).

- The WBI facilitated creation of a national steering committee to develop governance and anti-corruption reform.

C. Are there any new anticorruption activities planned as a result of this experience?

Continuation of work with civil society and Rule of Law.

D. Are there particular areas of vulnerability for corruption in USAID activities in this country?

Honduras is still very corrupt. Work with the NGO sector needs careful safeguards. Within the context of a relatively weak capacity to stem fraud and corruption through normal judicial channels, and a history of allegations of serious corruption at all levels, accountability and transparency need longer term attention to be sustainable.

“[T]ransparency and accountability efforts initiated with Hurricane Mitch supplemental funds require a longer time frame than available with supplemental funds to have lasting impact.” The important investments that USAID has made in building the capability of institutions and organizations to counter corruption that could have long-term impact could be lost without sustained follow-up.

E. Are there IG activities, audits or TA that should be noted?

See above. Also, the IG has worked with Honduras’ Supreme Audit Institution and has certified it as capable of performing audits in accordance with Government Accounting Standards.

F. Cooperation with other donors.

See above. The DCG continues to meet.

G. Did USAID work with any NGOs on anticorruption in this country?

Many. The NGO sector and civil society are more robust as a result.

H. What anticorruption recommendations would you make to missions about to undergo a significant ramp-up of assistance?

Make working on anticorruption and governance a priority. Give it high visibility.

INDONESIA CASE STUDY

CONTEXT

1. Nature of Ramp-up

In mid 1997, the Asian financial crisis struck hard at Indonesia's economy. In May 1998, the thirty year Suharto government was displaced. USG assistance to Indonesia increased from about \$35 million in 1997 to about \$99 million in 1998, then to almost \$200 million in 1999 and 2000. The level of USAID assistance remains high – about \$120 million in 2001 and 2002.

2. Corruption Issue

Indonesia is perceived as highly corrupt. Some points:³

- Under Suharto, administrative and political control were closely integrated. There was “a well-ordered patronage network” with funds flowing through Golkar (Suharto's political party).
- There were substantial economic changes in the late 1980s, but industries linked to the president's immediate relatives and closest cronies were protected from competition.
- “By the end of the 1990s, then, two closely interrelated systems of rent-seeking and patronage generation had come to exist side by side. The first involved routine bribery and official manipulation of budgets and government projects in a highly state-dominated economy. The second centered on the president's own family and closest cronies, and fed off the still incompletely liberalized and poorly regulated market economy.”
- Megawati has not completely repudiated the old system. Her appointments include people who are very familiar with how things worked.
- Corruption has become more chaotic. Multiple and competing centers of independent political actors seeking rents means more chaotic and less predictable corruption.

A. Did corruption become noticeably more of a problem with the ramp-up? What, if any, anti-corruption initiatives were underway before the ramp-up in assistance began?

May 1999 – USAID objectives: to promote improved electoral systems, to strengthen civil society, and to support democratic and political reforms. The Abdurrahman Wahid government, installed in Oct. 99, stated its intent to root out corruption.⁴

USAID programs followed usual prudent financial management procedures to protect funds from fraud and diversion. Project funds were not transferred to GOI. US partners were used on some projects. USAID financed technical advisers. These kinds of procedures were already in place – corruption did not become noticeably more of a problem with the ramp-up.

Perception appears to be worse now than it was during Suharto years. Ordinary people in Jakarta seem to have a sense of disappointment in the Megawati government concerning corruption.

³ These points are mostly based on the description of corruption under the Suharto regime set out in William Cole, “Roots of Corruption in the Indonesian System of Governance.” *Old Game or New: Corruption in Today's Indonesia*. Woodrow Wilson International Center, Asia Program Special Report. No. 100 (2001).

⁴ This came right after the Bank Bali scandal, which involved diversion of funds for benefit of Golkar. The donor community reacted strongly to this evidence of continued corruption under Habibie regime. WB and IMF held up release of funds for some time. Indonesian Bank Restructuring Agency (IBRA) tightened controls.

People expected a lot from her, but she hasn't moved against corruption as people hoped. However, it's difficult to say with any certainty whether corruption has increased. It's endemic.

There could be a perception of more corruption because there is more transparency, the media is more vibrant. At the same time, some people are being prosecuted and convicted for corruption. Governor of Central Bank – convicted – but he kept his job. Tommy Suharto – jailed.

B. What did USAID do to minimize or counteract corruption in connection with rapidly increased assistance in this country? Describe the activities and their results. What lessons were learned? Are there follow-up contacts or documents we should consult?

See discussion under (A) above. USAID assistance does not go directly to GOI, but to NGOs or through US based implementers, or to provide technical assistance through US advisers. Specifically regarding corruption, USAID sponsored Robert Klitgaard (US anticorruption expert), who consulted with the Supreme Court, Ombudsman, national police and others on how to address corruption. There are people in GOI who take a lead on anticorruption, including some at Supreme Court level.

NGOs - USAID works with hundreds of NGOs. Training and TA enhances their ability to monitor, gives them better insight into political processes. With proliferation of civil society groups, corruption within those groups has been a concern. USAID follows very strict financial guidelines, conducts audits. USAID also audits sub-grants made by US based implementers. Audits have shown that there are weaknesses in the NGO sector. USAID addresses these.

USAID has a Rule of Law program – Asia Foundation has been implementer. It has included work to strengthen the anticorruption commission. Issue has been should it have an enforcement capacity. It doesn't have such a capacity now. USAID also works with the office of the ombudsman, in particular to improve staff capacity. Donors have strongly supported the office of ombudsman. There is definitely donor pressure to increase the authority of the ombudsman.

Follow up question: Regarding the donor consultative groups, there is one targeted to corruption (KKN). Is the US involved? A: USG is part of this, though up until a few months ago, the Asia Foundation was the USG representative. USG is now becoming more involved.

C. Are there any new anti-corruption activities planned as a result of this experience?

Anticorruption activities are not related specifically to the ramp-up, but many USAID programs have an anticorruption component. For instance.

- Work with Bank Indonesia and IMF to strengthen the supervision and regulatory network for banks and other financial institutions, to oppose bank secrecy and reduce subsidized lines of credit, and promote market-oriented and deposit-based institutional development.
- Support for new legislation on bankruptcy procedures, secured transaction rules, business competition rules, and arbitration systems, new anti-money laundering law, open procedures for trade policy development.
- Support for development of an independent regulatory body within the Ministry of Telecom.
- Support for new investment laws, assistance with regulation of futures markets.
- Work with Ministry of Finance to improve openness, fairness and accountability in a number of areas, particularly relating to tax collections and audits (IG involvement).

- Work with judiciary, especially the Supreme Court.
- Support for LIPS 2 - Economic Law Institutionalization and Professional Strengthening.
- Training and TA to civil society NGOs so they have the capability to monitor and oversee government actions.
- A Rule of Law program with Asia Foundation as implementer. The program includes work to strengthen the government's anti-corruption commissions and the ombudsman.
- Work with the media. (WB diagnostic survey showed perception that media is among least corrupt institutions.)
- Work with local governments to increase transparency, and with media and civil society groups active locally to increase monitoring and oversight.

USAID will work with civil society groups in run-up to 2004 elections to try to increase integrity and transparency, constituency outreach. Resources are limited, but USAID program will address integrity in campaigning, financing.

D. Are there particular areas of vulnerability for corruption in USAID activities in this country?

There's a vulnerability when USAID works with NGOs that don't have financial management systems; USAID addresses this by providing training and by doing lots of audits. About 70% of the audit problems turned up are probably unintentional. About 25% show an indication that something is wrong.

Another vulnerability is training. Some individuals take personal advantage of overseas training opportunities.

Another vulnerability is working with local government. There is a vast range of different qualities and capabilities. While some are reform oriented and fed up with corruption, others are definitely not of that mindset.

Decentralization creates problems and opportunities. Corruption may increase at the local level, as more funds are available there, and more is skimmed off; but sometimes there are more reform-oriented people and parties at the local level, because people in the regions are fed up with corruption at the center.

E. Are there IG activities, audits or TA, that should be noted?

In February 2001, OIG signed an agreement with the Supreme Audit Institution of Indonesia. This represents a finding by the OIG that the SAI has adequate capability and independence to perform audits that comply with Government Auditing Standards, and is eligible to conduct audits of USAID funding.

There was an IG report on D&G programs in Indonesia. See the report. Recommendations were minimal.

F. Cooperation with other donors

1. *What kind of collaboration is there between donors, including USAID, on corruption issues?*
2. *Have other donors had particular problems with fraud or corruption?*
3. *Is this country signatory to any international conventions on corruption?*

See discussion above on Donor Cooperative Group. World Bank and other donors that work directly with GOI have different and greater vulnerabilities than USAID. Recently the ADB has been active in anticorruption in Indonesia.

G. Did USAID work with any NGOs on anti-corruption in this country?

Yes. See above. USAID has worked extensively with civil society NGOs, and will be working more with them on election monitoring, election integrity.

H. What anticorruption recommendations would you make to Missions about to undergo a significant ramp-up of assistance?

Don't get spread too thin. In a ramp-up situation, there's an abundance of local organizations that spring up to take advantage of the possibilities. If USAID gets involved in too many things, monitoring and review suffer. It's better to focus on a few things and do it more intensively.

Get buy in from the relevant government entity. In an emergency situation, there's pressure to program rapidly, to overlook potential problems, to require less commitment. This creates vulnerabilities.

Put good procedures in place from the beginning. Make resources available for monitoring and review, have an audit capacity in place from the start.

SOUTH AFRICA CASE STUDY

CONTEXT

There is a review of corruption ongoing in SA currently covering the period 200 - 20022. Unless otherwise indicated, this case study relates not to this ongoing study, but rather to the early to late nineties, the period involved in the ramp-up of assistance to SA in the transition from apartheid to democratic governance.

Corruption was extensive in the apartheid government and it is acknowledged that this culture of corruption carried over into the democratic regime with the transition in 1994. It is reported that many people feel that there has been an increase in administrative corruption since 1994. (Tom Lodge in Heidenheimer and Johnson 2002, Constanze Bauer in Hope and Chiculo 2000).

There was risk of this corruption effecting the USAID program. The ramp-up in assistance that accompanied the transition to democracy was accompanied by great political pressure. President Mandela expected something in the magnitude of the 1979 Middle-East settlement in aid levels from the US. In reality, the initial pledge was \$600 million over three years 94/96/97 which ultimately grew to a billion, roughly a third of which was not USAID funding. Moreover, roughly 60% of USAID funding was for Technical Assistance. Responding to pressure from Mandela for more US aid, the US Congress and White House pressed for rapid disbursement of USAID funding. The mantra was to obligate the funds quickly and widely, especially for the institutional grant portions of the funding. (Lyman 2002 plus SA case interviews.) This put great pressure on the USAID mission, which felt it was understaffed for the required workload.

QUESTIONS

A. Did corruption become noticeably more of a problem with the ramp- up?

Corruption of the USAID program per se was not seen as a major problem because of the nature of the assistance, mostly Technical Assistance, and the due diligence applied to the grants program for NGOs. The grant program was run mostly through direct USAID management. For example, the Rule of Law unit managed around 150 small grants of \$10-30,000. Direct management has so many controls that there is not much room for diversion or misuse. But, while accountability was assured, the administrative cost/burden was enormous. Moreover, there was little chance that the USAID program had an impact on corruption in a general sense, because of the nature of the program.

Was there more ability to address corruption because of the ramp-up?

Actually, the Mission felt that they needed more staff than was available to manage the program properly. They went to the practice of hiring spouses under contract to personally look after grant follow-up in a kind of "gum-shoe" corps under the Controller's office.

What, if any, anti-corruption initiatives were underway before the ramp-up in assistance began?

None. This took place prior to the emergence of corruption as a key issue for donors, the political scene was dynamic and unpredictable, and the ramp-up was cobbled together really at the last moment when transition finally became assured. Prior to that, USAID was not even

dealing with the South African Government -- focusing virtually its entire program through NGOs.

B. What did USAID do to minimize or counteract corruption in connection with rapidly increased assistance in this country? Describe the activities and their results.

1. *Nature and management of assistance.* Use of primarily project assistance directly managed by USAID and its contractors. Project assistance and direct management left little recourse for mismanagement of resources.
2. *Direct USAID management of its grant program* -- example from rule-of-law area:
 - a. Commissioned an accounting firm to do sample audits of the small grants program. Of 20 grantees audited, only one was found to have no proper financial controls).
 - b. For organizations receiving grants of \$100,000 or more, there was a pre-award survey to determine that the grantee's financial management system was adequate for managing USAID funding (in the legal area, most awards were to private law firms and public interest law firms who had very good financial systems and all had successful projects and they are still contractible).
3. *Rapid response to illicit uses of funds.* In the few instances where irregularities were encountered, the programs were stopped immediately and payback was obtained. This may have had some broader influence because when there was a scandal in the mid-1990s involving misuse of donor funding by a prominent member of the ANC, that person was convicted and jailed for the offense.
4. *Regional seminars for grantees.* Four seminars, one in each of four regions, were held to train grantees in financial management, accountability, field support, USAID procedures and requirements and closeout. These programs were held in conjunction with the D&G Office, the Controller auditors and the RIG. USAID staff were also trained in a similar set of topics. In the final analysis, very little corruption was found among USAID grantees. Also, in all probability, the impact of these programs went beyond USAID grantees. Training for NGOs still continues.
5. *Institutional strengthening grants.* These were provided as needed to help grantees with all aspects of their work.
6. *Closeout team.* Faced with lack of staff and hundreds of grants to follow, USAID hired staff spouses to follow-up with each and every grant on the books for proper closeout. Few problems were found. Most of these involved the disappearance of the NGO grantee. In these cases, individuals were tracked down, records were reviewed and restitution made as appropriate. Where there was no trace, there was little recourse, but these cases were few and far between.
7. *Controller's Office self assessment.* The Controller's Office was made to do a self assessment during the ramp-up period and to close out all recommendations. An external management review found the office to be sound.

Most of the USAID anti-corruption activities aimed beyond the USAID program per se, came well after the ramp-up in the transition years. However, while corruption still is a very serious problem in South Africa and may even be worse since transition, much progress has been made in laying the foundations for reducing corruption. The legal framework for budgetary transparency has improved and now meets or exceeds IMF standards, including checks and balances, clarity of constitutional roles, participation, and management of extra-budgetary activities (Africa Fiscal

Transparency). The criminal justice system has been strengthened. The role of civil society organizations and NGOs is being enhanced, including increased partnerships with government for service delivery. Local government responsiveness to citizen needs is being improved. Economic policy reform is streamlining government regulation and this reduces opportunity for rent seeking and bribes.

What lessons were learned?

- ❑ Despite pressures to the contrary, USAID opted for predominantly project assistance. Given the persistent level of corruption in the country, this was the right choice.
- ❑ Lacking adequate personnel staffing levels for the politically pressured ramp-up, USAID might have been better off if it had it sought organizations to manage its grants programs and closely managed those contractors.
- ❑ Pre-award surveys are worth the effort.
- ❑ Controller and audit functions take on particular importance in a ramp-up. A special unit in the Controller's office was needed to closeout the hundreds of grants that had been made. Unspent money was pulled or for de-op re-ob purposes. USAID hired a former Controller as Deputy Director to help keep a tight ship during the ramp-up.
- ❑ Coordination with the RIG is important and helpful.
- ❑ Grants should be reviewed each year as part of the vulnerability assessment process and tightened up as necessary.

C. Are there any new anti-corruption activities planned as a result of this experience?

The Economic Policy and D&G programs have anti-corruption dimensions, but these programs are not a direct result of the ramp-up at transition nor do they address corruption directly.

The Mission's Democracy and Governance unit currently is looking at corruption as a growing area of concern given the devolution of authority, responsibility and resources to the some 280 newly created local government entities. Other Mission Strategic Objectives and programs will be working with the new local government entities, so the Mission's efforts to understand and address corruption issues will expand.

D. Are there particular areas of vulnerability for corruption in USAID activities in this country? In host country operations?

- ❑ Non project assistance is more vulnerable to assistance than its alternative.
- ❑ When political forces are driving a program, sometime prudent management is seen as a secondary consideration. Even under political pressures, it is better to go step-by-step. The USAID South Africa program was under such political pressures and could have fallen prey to corruption, but it did not.
- ❑ Where there is not separation of payment and operations functions in an organization, the potential for fraud and mismanagement is very great. These functions should be separated in any organization with which USAID works.
- ❑ Highly decentralized programs incur a greater risk than more centralized and limited activities so greater caution is required.

E. Are there IG activities, audits or TA, that should be noted?

Cooperation in staff, contractor and grantee training.

F. Cooperation with other donors

Donor coordination is effective in SA, and is organized by sector. USAID also cooperates closely with other USG agencies with assistance programs, such as the Departments of Justice and State.

G. Did USAID work with any NGOs on anti-corruption in this country?

As noted, the ramp-up program had a very large NGO support program and that included training on financial management, audit and accountability.

H. What anti-corruption recommendations would you make to Missions about to undergo a significant ramp-up of assistance?

- ☐ Neglect the controller/audit and the grantee financial management functions at your peril.
- ☐ Staff up adequately to manage and monitor the increase in activity.
- ☐ Go for project assistance.
- ☐ Direct management of large small grant programs should be contracted out. USAID should not take on this task directly. Also, multiple small grant closeout is a labor intensive process. Prepare.

UKRAINE CASE STUDY

CONTEXT

The ramp-up in Ukraine started in the mid-1990s. The context was the economic and political transition that was happening throughout the NIS. Ukraine was a particularly important country given its strategic importance as a buffer between Russia and Eastern Europe, a bridge between Europe and Eurasia, its size, the large Ukrainian population in the US and Russia's strong interest in having Ukraine return to the fold. At the time of ramp-up, the country was in serious trouble, experiencing hyper-inflation (1994-5), followed by a banking crisis in 1998.

CORRUPTION

Corruption in Ukraine is a persistent problem. AMEMBASSY KIEV 2687 (2002) states that "corruption pervades all levels of society and government and all spheres of economic activity." There has been some improvement in some areas in recent years, but, by and large, corruption has not improved since the period of the ramp-up. On the Freedom House index of corruption, there is no movement from 1999-2002. A recent USAID funded poll indicated that 72% of respondents think that corruption has gotten worse in the past five years. There seems to be an attitude that as long as a corruption is shared around, it is not corruption. There is little distinction as to what is a public good and what is not.

QUESTIONS

A. Did corruption become noticeably more of a problem with the ramp- up?

The ramp-up did not create a serious problem for USAID. Most of the assistance was TA and training and therefore not especially vulnerable to corruption. Mission programs were not seriously impacted by corruption nor did the program have any impact on corruption in the country.

There was some minor petty corruption that effected the Mission's programs, such as:

- Creating phony receipts -- very easy to do and difficult to detect.
- Pre-arranging for commodities, like computers, to be purchases from a particular store.
- Mixing funds between grants and double-billing for the same service.

However, it is highly likely that the IMF and World Bank loans made at the time did have an impact on corruption by undercutting the political will to reduce corruption. The loans made it possible for the government to get by without making tough decisions about revenues. Revenues were in shortfall because of a variety of corrupt activities, such as:

- Oligarchs were taxed at favorable rates.
- Favored firms were given the ability to declare bankruptcy.
- There were special exchange rates for the privileged and those willing to bribe.
- Privatization transferred assets to selected people at well below market price.

Since those early days, the Bank and IMF are more conscious of the role of good governance.

What, if any, anti-corruption initiatives were underway before the ramp-up in assistance began?

There was no stand-alone anti-corruption program in operation at the time of the ramp-up.

Was there more ability to address corruption because of the ramp-up?

Yes. Anti-corruption activities started in 1995/96 during the large ramp-up. See below.

B. What did USAID do to minimize or counteract corruption in connection with rapidly increased assistance in this country? Describe the activities and their results. What lessons were learned? Are there follow-up contacts or documents we should consult?

Anti-corruption activities started during the ramp-up included working on commodities exchange, media and good governance. Other activities undertaken that were corruption reducing in nature included:

- Improving the small-scale business environment.
- Improving the cultural environment for reduced corruption, e.g. by promoting transparency.
- Promoting investigative journalism.

There followed an array of Mission economic, policy, financial and governance reform and institutional development activities that worked indirectly on the corruption issue by promoting transparency, competition, privatization and deregulation. Most USAID projects directly or indirectly address corruption issues and employ prevention and public awareness in their sectoral work.

The Mission was very aware of the omnipresent threat of corruption within its own programs and worked hard to design programs that were not susceptible to corruption. Programs were monitored closely and tendering was the rule.

Grants were seen as an area of vulnerability. The Mission instigated very careful monitoring of grants. Major grantees were required to do close monitoring of their sub-grantees. Some problems were uncovered and were addressed.

An Anti-Corruption Support project was started in 1997 which worked primarily at the level of the oblast. The project focused on developing public-private partnerships and action plans, citizen advocacy offices, and a national coalition for integrity among participating oblasts. Action plans included work on preventive reforms, public awareness and education campaigns, enforcement actions, and work on building legitimacy and sustainability. The MSI final report on this program suggests some important lessons learned, namely:

- The basic elements of this program, in combination, proved effective for anti-corruption work.
- Local ownership and legitimacy (enforcement and making a difference) are essential to success.
- Political will of political, civil society and business leaders is a critical ingredient for success.

This work is being expanded to more regions in the current "Fostering Anti-Corruption Public Actions in Ukraine" project.

Results: While causality is difficult to establish, opinion polls indicate there is a growing concern on the part of the public that corruption is a widespread problem and a key issue that must be tackled. In a 2002 national survey 61 percent said that citizens and NGOs should become more active in fighting corruption. Moreover, 22 percent indicated they would be willing to participate -- this is up from around 5% in the immediate post Soviet period.

Also, there have been signs that at least some elements of the government are catching on. See the establishment of anti-corruption activities in the Parliament, above, and there have been new government initiatives to hold managers of state enterprises accountable for their actions. Reform in the financial sector also is promising.

C. Are there any new anti-corruption activities planned as a result of this experience?

As noted, the anti-corruption work started with the ramp-up and has expanded since that time. See above.

D. Are there particular areas of vulnerability for corruption in USAID activities in this country? In host country operations?

The Energy Sector is notorious for its grand scale corruption. There is a continuing battle for control of this sector -- for the key industries, sector banking and especially the natural gas piped in from Russia. A former Prime Minister is being held in the USA on money laundering charges having to do with this sector.

The executive branch, Tax Inspectorate and Internal Affairs also are well known for corrupt practices.

Within the USAID program, the grants area bears careful watching.

E. Are there IG activities, audits or TA, that should be noted?

IG audits uncovered problems in the Eurasia Foundation. Some staff were signing documents for ghost accounts. The program was shut down while the IG investigation and restitution were taking place.

The IG was also called in to audit the Freedom House and Free Trade Union Institute (FTU) programs.

The government has established an Auditing Chamber in Parliament, charged with seeing that the revenues go to the right sectors as appropriated.

An Anti-corruption Committee was started in the Parliament by a few powerful Members. It persists but is having only limited success.

F. Cooperation with other donors

1. What kind of collaboration is there between donors, including USAID, on corruption issues?

There are donor coordinating meetings on the subject of corruption and anti-corruption activities.

2. Have other donors had particular problems with fraud or corruption?

SOROS and other donors with large grant programs have had problems.

3. Is this country signatory to any international conventions on corruption?

Council of Europe and Organization for Security and Cooperation in Europe.

G. Did USAID work with any NGOs on anti-corruption in this country?

USAID has a very active grant program for NGOs. In fact, working with NGOs to strengthen civil society is an element of the Mission's strategy for fighting corruption.

H. What anti-corruption recommendations would you make to Missions about to undergo a significant ramp-up of assistance?

- ☐ Try to avoid projects that are susceptible to corruption.
- ☐ Institute very careful monitoring of grant programs.
- ☐ Tackle corruption from a dual perspective: (a) address high level corruption through public diplomacy and policy advocacy; (b) fight petty corruption through support to non-governmental organizations.
- ☐ Anti-corruption efforts at the top levels will only be successful if accompanied by campaigns at the regional level where corruption directly impacts the lives of people. Create anti-corruption partnerships between government, civil society and business at this level. Create national coalitions among these partnerships.